

Understanding the Insolvency and Bankruptcy Code, 2016

Analysing
developments in
jurisprudence



सत्यमेव जयते

भारतीय दिवाला और शोधन अक्षमता बोर्ड

Insolvency and Bankruptcy Board of India

www.ibbi.gov.in

V | D H | Centre for
Legal Policy

Disclaimer: This publication has been prepared by the Vidhi Bankruptcy Research Programme at the Vidhi Centre for Legal Policy and the Legal Division of the Insolvency and Bankruptcy Board of India. It presents legislative and judicial developments till 31st March, 2019 on fifteen select issues. It is intended to be used for educational purposes only and must not be construed to be a guide for taking or recommending any action or decision, commercial or otherwise. Please seek professional advice before taking any action or decision using the material presented here.

[Page intentionally left blank]

Foreword

The Insolvency and Bankruptcy Code, 2016 ('Code') reconceptualised the framework for insolvency resolution in India. It provides a mechanism for the insolvency resolution of debtors in a time bound manner to enable maximisation of the value of their assets, with a view to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders.

The Code separates commercial aspects of insolvency and bankruptcy proceedings from judicial aspects and empowers and facilitates the stakeholders and Adjudicating Authority to decide matters within their respective domain expeditiously. It envisages a market mechanism to rescue firms in financial distress and to facilitate closure of firms in economic distress, in accordance with the processes under the Code and rules and regulations made thereunder.

An economic legislation is typically a skeleton structure. Judicial pronouncements provide flesh and blood to it and resolve grey areas. It takes several years, at times decades, for a major economic law to settle down and for there to be complete clarity, certainty and predictability for stakeholders. The Adjudicating Authority, the Appellate Authority and judiciary have been at the forefront of the implementation of the Code. They have settled several conceptual and contentious issues expeditiously and delivered several landmark orders, bringing in clarity as to what is permissible and what is not, and streamlining the process for the future.

This publication traces legislative and judicial developments on fifteen select issues that have been heavily litigated in the last two and a half years. It provides a birds' eye view of the settled legal position on these issues and analyses the rationale behind this position. I believe that it will help all stakeholders gain a better understanding of the Code and the jurisprudence that has enriched practice under it.

Dr. M.S. Sahoo
Chairperson
Insolvency and Bankruptcy Board of India

Preface

The Code was enacted in 2016 following a series of recommendations to revamp India's insolvency framework. It was hoped that it would provide a consolidated insolvency framework that would give certainty of process, time and outcome to creditors, borrowers and other market participants.

In the three years since its enactment, the Code has largely lived up to this promise. The National Company Law Tribunals, the National Company Law Appellate Tribunal, the High Courts and the Supreme Court have adjudicated upon matters under the Code with unprecedented speed, and have provided certainty on interpretation of key concepts under it. The Insolvency and Bankruptcy Board of India and the Government of India have also been extremely responsive in making legislative amendments to ensure that the Code is implemented in its right spirit. These developments have enriched the jurisprudence and practice of insolvency in the country.

We, at the Vidhi Centre for Legal Policy, take great pride in having being involved in the conceptualization and implementation of the Code. As the legal framework of the Code is tested and reinforced through jurisprudential developments, we believe it is key to constantly engage with these developments to fully understand the shape this reform is taking. I am extremely grateful to the Insolvency and Bankruptcy Board of India for encouraging us to track and analyse these developments in this publication, and for collaborating with us on this.

I am also grateful to Mr. Debanshu Mukherjee, Ms. Anjali Anchayil, Mr. Suharsh Sinha, Mr. Vinod Kothari and Ms. Sikha Bansal for their inputs on this publication, and to Ms. Priya Jaisingh, Ms. Medha Haradhan, Mr. Abhishek Nippani, Ms. Shaileja Verma and Mr. Aastik Ahuja for excellent research assistance. We hope that this publication will serve as a useful resource for insolvency practitioners and other stakeholders in the eco-system.

As jurisprudence on the Code develops further, we hope that it continues to strengthen the foundations of India's insolvency framework, and enhances certainty for all participants.

Shreya Prakash,
Coordinator,
Vidhi Bankruptcy Research Programme

Table of Contents

<i>Constitutionality of the provisions of the Code</i>	<i>7</i>
<i>Repugnancy of State Laws with the Code</i>	<i>11</i>
<i>The Concept of “Operational Debt” and “Financial Debt” under the Corporate Insolvency Resolution Process.....</i>	<i>13</i>
<i>Timelines under the Code</i>	<i>16</i>
<i>Decoding “Dispute” under the Corporate Insolvency Resolution Process.....</i>	<i>20</i>
<i>Right of Hearing on Admission of an Application under the Code.....</i>	<i>23</i>
<i>Supply of Critical Goods and Services during the Corporate Insolvency Resolution Process.....</i>	<i>25</i>
<i>Provision for Mutual Settlement after the Admission of a Case under the Code.....</i>	<i>28</i>
<i>Liability of Guarantors during the Corporate Insolvency Resolution Process.....</i>	<i>31</i>
<i>Assignment of Debts of Related Parties under the Corporate Insolvency Resolution Process</i>	<i>34</i>
<i>Treatment of Home Buyers in the Corporate Insolvency Resolution Process</i>	<i>36</i>
<i>Treatment of Statutory Dues under the Code</i>	<i>38</i>
<i>Dissenting Financial Creditors under the Code.....</i>	<i>40</i>
<i>Applicability of section 29A of the Code</i>	<i>42</i>
<i>Distributions under a Resolution Plan</i>	<i>45</i>

Constitutionality of the provisions of the Code

Introduction

The Code was enacted in 2016 following decades of recommendations suggesting improvements to the previous insolvency regime, which was fragmented, fraught with delays and resulted in poor recoveries for creditors.¹ The scheme of the Code marked a sea change from the previous regime. In respect of corporate entities, the Code introduced a creditor-in-control regime (with a focus on empowering financial creditors), a time-bound resolution process and reduced scope for judicial intervention, and established institutions such as the Insolvency and Bankruptcy Board of India, insolvency *professionals* and information utilities.

Since the implementation of this new regime, the constitutional validity of various provisions of the Code has been challenged before various High Courts, and the Supreme Court.

Analysis

One ground on which the validity of the Code was challenged was that the process for initiation of the corporate insolvency resolution process was not consistent with the principles of natural justice. In *Sree Metaliks Ltd. v. Union of India*,² the constitutionality of section 7 was challenged on the ground that the provision does not provide the corporate debtor an opportunity to be heard before an application to initiate an insolvency resolution process against it is admitted. The petitioner argued that since the provisions of the Code are silent on the right of the corporate debtor to be heard, the right to hearing should be read into the provision. The Court relied on section 424 of the Companies Act, 2013, to hold that even though the Code is silent on the right of hearing of the corporate debtor, “where a statute is silent on the right of hearing and it does not in express terms, oust the principles of natural justice, the same can and should be read into it.” Accordingly, the Court held that the Adjudicating Authority is obliged to give reasonable opportunity to be heard to the corporate debtor.

The Calcutta High Court also delved into the question of constitutionality of certain provisions of the Code. In *Akshay Jhunjhunwala and Anr. v. Union of India*,³ the validity of sections 7, 8 and 9 was challenged. It was argued that the differentiation made between the operational and financial creditors by these provisions does not have a rational or intelligible basis and is therefore, liable to be struck down. The Calcutta High Court relied on the Report of the Bankruptcy Law Reforms Committee, wherein the Committee had opined that “members of the creditors committee have to be creditors both with the capability to assess viability, as well as to be willing to modify terms of existing liabilities in negotiations. Typically, operational creditors are neither able to decide on matters regarding the insolvency of the entity, nor willing to take the risk of postponing payments for better future prospects for the entity... for the process to be rapid and efficient, the Code will provide that the creditors committee should be restricted to only the financial creditors.” Given this, the Court held that “the Bankruptcy Committee gives a rationale to the financial creditors being treated in a particular way vis-à-vis an operational creditor in an insolvency proceeding with regard to a company. The rationale is a plausible view taken for an expeditious resolution of an insolvency issue of a company. Courts are not required to adjudge a legislation on the basis of possible misuse or the crudities or inequalities that may be perceived to be embedded in a legislation. The rationale of giving a particular treatment to a financial creditor in the process of insolvency of a company under the Code of 2016 cannot be said to offend any provisions of the Constitution of India.”

¹Bankruptcy Law Reforms Committee, The Interim Report of the Bankruptcy Law Reforms Committee (2015)

²*SreeMetaliks Ltd. v. Union of India*, Writ Petition 7144 (W) of 2017. Decision date- 07.04.2017

³*AkshayJhunjhunwala and Anr. v. Union of India*, Writ Petition No. 627 of 2017. Decision date- 02.02.2018

In *Shivam Water Treaters Pvt. Limited v. Union of India*,⁴ the Supreme Court requested the Gujarat High Court to refrain from entering the debate relating to the “*validity of the Insolvency and Bankruptcy Code, 2016 or the constitutional validity of the National Company Law Tribunal.*” However, it did not bar the petitioners from challenging the same before the Supreme Court under Article 32.

Thereafter, the constitutional validity of various provisions of the Code was challenged before the Supreme Court. In its judgment in *Swiss Ribbons Pvt. Ltd. v. Union of India*,⁵ the Supreme Court held that the judiciary should exercise restraint while examining the constitutional validity of economic legislation since “*in complex economic matters every decision is necessarily empiric and it is based on experimentation or what one may call trial and error method and therefore, its validity cannot be tested on any rigid prior considerations or on the application of any straitjacket formula.*”⁶ In this background, the Court upheld the constitutional validity of all the provisions challenged before it.

A large number of the challenges before the Court were against the provisions that treated financial creditors and operational creditors distinctly. First, the Court observed the distinction between financial debt and operational debt in the following terms “*a financial debt is a debt together with interest, if any, which is disbursed against the consideration for time value of money. It may further be money that is borrowed or raised in any of the manners prescribed in Section 5(8) or otherwise, as Section 5(8) is an inclusive definition. On the other hand, an ‘operational debt’ would include a claim in respect of the provision of goods or services, including employment, or a debt in respect of payment of dues arising under any law and payable to the Government or any local authority.*”⁷ It further relied on the Final Report of the Bankruptcy Law Reform Committee, the Notes on Clause 8 of the Insolvency and Bankruptcy Bill, 2015 and the Report of the Insolvency Law Committee, to broadly lay down the distinctions between financial and operational creditors as “*most financial creditors, particularly banks and financial institutions, are secured creditors whereas most operational creditors are unsecured, payments for goods and services as well as payments to workers not being secured by mortgaged documents and the like.*”⁸ The Court also distinguished between the nature of agreements entered into with financial creditors and operational creditors, where the former generally lends for working capital or on a term loan and involves a larger quantum of money as compared to the latter where the agreement mostly relates to the supply of goods and services. Therefore, the Court held that the distinction between the two is based on intelligible differentia with a rational nexus to the objectives that the Code seeks to achieve. Secondly, the Court highlighted that the most significant difference between financial and operational creditors is that “*financial creditors are, from the very beginning, involved with assessing the viability of the corporate debtor. They can, and therefore do, engage in restructuring of the loan as well as reorganization of the corporate debtor’s business when there is financial stress, which are things operational creditors do not and cannot do.*”⁹ This was relied on, along with the legislative and case law developments that guarantee fair and equitable treatment to operational creditors, to hold that the provisions giving only financial creditors the right to vote as part of the committee of creditors are valid. Thirdly, the Court also analysed if the difference in the process for triggering the corporate insolvency resolution process by operational creditors and financial creditors was arbitrary. The Court held that since financial creditors have to prove that there is “default” on the basis of solid documentation, or information in an information utility that is easily verifiable, it was justifiable that they were not required to provide a demand notice to the corporate debtor. This is contrary to the requirement imposed on an operational creditor to provide a demand notice to the corporate debtor, who only “*claims a right to payment of a liability or obligation in respect of a debt which may be due.*”¹⁰ Finally, the validity of section 53 of the Code was challenged on the grounds that it was discriminatory towards operational creditors. The Court held that given the relative importance of the two types of debts, particularly the importance of repayment of financial debts for

⁴ *Shivam Water Treaters Pvt. Ltd. v. Union of India*, SLP No.1740/2018. Decision date- 25.01.2018

⁵ *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India*, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019

⁶ *Ibid.*

⁷ *Ibid.*

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Ibid.*

promoting capital availability in the economy, a legitimate interest was being protected by section 53 of the Code.

Various challenges were also raised against the validity of section 29A. The validity of this section was challenged on the grounds that *first*, it had retrospective application. The Court held that since a resolution applicant does not have a vested right in being considered as such in the resolution process, the section cannot be held to be retrospective. *Secondly*, it was argued that section 29A(c) holds unequals as equals by treating promoters who did not act with malfeasance on par with those who had. The Court held that section 29A was intended to apply to persons other than criminals or those who had been malfeasant, and this was justified by the legislative purpose of the section. *Thirdly*, it was argued that placing a bar on persons disqualified under section 29A from purchasing any assets of the corporate debtor in liquidation as well would be contrary to the purpose of maximizing the value of the assets of the corporate debtor. This contention was rejected on the ground that the legislative purpose would continue to apply even in liquidation. *Fourthly*, it was argued that the period of one year prescribed in section 29A for the disqualification to apply was arbitrary and without basis. The Court held that it was legislative policy that a person who is unable to service its own debt beyond the grace period of one year, is unfit to be eligible to become a resolution applicant, and “*this policy cannot be found fault with. Neither can the period of one year be found fault with, as this is a policy matter decided by the RBI and which emerges from its Master Circular, as during this period, an NPA is classified as a substandard asset.*”¹¹ *Fifthly*, it was argued that the disqualification of relatives of persons who are disqualified in section 29A was arbitrary. The Court held that “*The expression “related party”, therefore, and “relative” contained in the definition Sections must be read noscitur a sociis with the categories of persons mentioned in Explanation I, and so read, would include only persons who are connected with the business activity of the resolution applicant.*”¹² *Finally*, it was argued that the exemption of MSMEs from section 29A was arbitrary. The Court held that it was not arbitrary since “*the rationale for excluding such industries from the eligibility criteria laid down in Section 29A(c) and 29A(h) is because qua such industries, other resolution applicants may not be forthcoming, which then will inevitably lead not to resolution, but to liquidation.*”¹³

The Court also examined the validity of section 12A that was challenged as being violative of Article 14, largely since the withdrawal of a petition under section 12A requires the approval of ninety per cent of the Committee of Creditors. The Court emphasized that an insolvency proceeding is a proceeding *in rem* and not a *lis* between parties. Consequently, and as also explained in the report of the Insolvency Law Committee “*all financial creditors have to put their heads together to allow such withdrawal as, ordinarily, an omnibus settlement involving all creditors ought, ideally, to be entered into. This explains why ninety per cent, which is substantially all the financial creditors, have to grant their approval to an individual withdrawal or settlement.*”¹⁴ Further, if the committee of creditors arbitrarily rejects an application for withdrawal, their decision can be set aside by the Adjudicating Authority or the Appellate Authority. Given this, the court also upheld the validity of this provision.

Provisions of the Code were also challenged on the grounds that the information stored in private information utilities should not be the conclusive evidence of default, and that these utilities are not governed by proper norms. The Court took note of the Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017 and held that “*the aforesaid Regulations also make it clear that apart from the stringent requirements as to registration of such utility, the moment information of default is received, such information has to be communicated to all parties and sureties to the debt. Apart from this, the utility is to expeditiously undertake the process of authentication and verification of information, which will include authentication and verification from the debtor who has defaulted. This being the case, coupled with the fact that such evidence, as has been conceded by the learned Attorney General, is only prima facie evidence of default, which is rebuttable by the corporate debtor, makes it clear that the challenge based on this ground must also fail.*”¹⁵

¹¹ *Ibid.*

¹² *Ibid.*

¹³ *Ibid.*

¹⁴ *Ibid.*

¹⁵ *Ibid.*

It was also argued that by giving adjudicatory powers to a non-judicial authority, that is, the resolution professional, the Code violates the basic aspects of dispensation of justice and access to justice. This contention was also rejected by the Court on the grounds that “*the resolution professional is really a facilitator of the resolution process, whose administrative functions are overseen by the committee of creditors and by the Adjudicating Authority.*”¹⁶

The Court also dealt with challenges to the appointment of members of the National Company Law Tribunal (“NCLT”) and the National Company Law Appellate Tribunal (“NCLAT”) which are the Adjudicating Authority and Appellate Authority for corporate debtors, respectively, under the Code, the location and number benches of the NCLAT and the Ministry which would exercise administrative control over the NCLT and NCLAT.¹⁷ While the Supreme Court passed directions regarding the administrative control over the NCLT and the establishment of circuit benches of the NCLAT, it upheld the validity of the NCLT and NCLAT.

Conclusion

The provisions of the Code pertaining to initiation of the corporate insolvency resolution process, voting in the committee of creditors, distribution in liquidation, withdrawal of the corporate insolvency resolution process, disqualification from submitting a resolution plan, information utilities and powers of the resolution professional have been held valid.

¹⁶ *Ibid.*

¹⁷ One ground of challenge was regarding the appointment of members of NCLT and NCLAT, which was contended to be contrary to the judgment in *Madras Bar Association v. Union of India*. Rejecting the contention of the petitioner, the Court held that in compliance with the directions of the Court in the abovementioned judgment, a selection Committee was formed for the appointment of members of the NCLT. Further, advertisements were issued inviting applications for Judicial and Technical members of the Tribunal. The petitioners then argued that since the NCLAT has only one bench in New Delhi, the appellate remedy is rendered “inefficacious”, for the people from other states who could have earlier, before the NCLAT was made the appellate forum, easily approached the High Courts in their respective States. Thus, the NCLAT lacks the “*convenience and expediency*” that the Highs Courts provided and runs contrary to the dictum in *Madras Bar Association*. However, the Attorney General assured the Court that Circuit Benches will soon be established to comply with the directions of the Court in *Madras Bar Association*. Thus, in furtherance of this assurance, the Court directed the Union government to establish these Circuit Benches within 6 months from the date of judgment. In addition to this, in regards to the issue of the NCLT/ NCLAT functioning under administrative control of the Ministry of Corporate Affairs instead of Ministry of Law and Justice as mandated by the decision in *Madras Bar Association*, the Court directed that the Union Government must comply with the same.

Repugnancy of State Laws with the Code

Introduction

The Code was enacted with a view to consolidate the fragmented laws pertaining to insolvency. The purpose of consolidating various insolvency laws is to reduce the uncertainty that arises from the application of multiple laws administered by different authorities, and the consequent delay and reduction in value.

To enable this consolidation, the Code repeals and modifies provisions of various laws that are directly in conflict with it.¹⁸ However, the scheme of various laws enacted by Parliament as well as by State Legislatures may still be found to be inconsistent with other laws. Given this, it is relevant to explore the manner in which such inconsistency will be dealt with.

Analysis

An inconsistency between different legislations is dealt with in different ways based on the type of legislation in question.

An inconsistency between a State Law and a Central Law is dealt with pursuant to the principles in Article 254 of the Constitution which provides that

“(1) If any provision of a law made by the Legislature of a State is repugnant to any provision of a law made by Parliament which Parliament is competent to enact, or to any provision of an existing law with respect to one of the matters enumerated in the Concurrent List, then, subject to the provisions of clause (2), the law made by Parliament, whether passed before or after the law made by the Legislature of such State, or, as the case may be, the existing law, shall prevail and the law made by the Legislature of the State shall, to the extent of the repugnancy, be void.

(2) Where a law made by the Legislature of a State with respect to one of the matters enumerated in the Concurrent List contains any provision repugnant to the provisions of an earlier law made by Parliament or an existing law with respect to that matter, then, the law so made by the Legislature of such State shall, if it has been reserved for the consideration of the President and has received his assent, prevail in that State:

Provided that nothing in this clause shall prevent Parliament from enacting at any time any law with respect to the same matter including a law adding to, amending, varying or repealing the law so made by the Legislature of the State.”

Given that, Entry 9 of List III of the Seventh Schedule to the Constitution of India provides that both the Parliament and State Legislatures have legislative competence over “bankruptcy and insolvency”, a possibility of inconsistency between such legislations arises.

Where an issue of repugnancy between the Maharashtra Relief Undertakings (Special Provisions) Act, 1958, which is a state law, and the Code arose, the Supreme Court in its judgement of *Innoventive Industries v. ICICI Bank*¹⁹ laid down key principles to evaluate repugnancy of a state law with a union law. Specifically, the Court laid down that *first*, the doctrine of pith and substance should be applied to determine if a Parliamentary law and State law both refer to the Concurrent List. Only if both fall within this list, the principles of repugnancy under Article 254 will be applicable. *Secondly*, every effort should be made to reconcile the competing statutes to avoid repugnancy. *Thirdly*, repugnancy must exist in fact and not depend upon a mere possibility. *Fourthly*, repugnancy must be clear and typically of a nature to bring both statutes in direct conflict with each other, such that it would be impossible to obey one without disobeying the other. *Fifthly*, if Parliamentary law is intended to be a complete, exhaustive or exclusive code on a matter, State law may be inoperative even if there is no direct conflict. This may be the case where application of the State law hinders or obstructs the scheme of the

¹⁸ Section 243, and the Schedules to the Code

¹⁹ *M/s Innoventive Industries Ltd. v. ICICI Bank*, Civil Appeal Nos. 8337-8338 of 2017. Decision date- 31.08.2017

Parliamentary law. *Sixthly*, a conflict may also arise where both Parliamentary and State law seek to exercise powers over the same subject matter even if there is no direct conflict. Here the doctrine of implied repeal would be applied such that *“if the subject matter of the State legislation or part thereof is identical with that of the Parliamentary legislation, so that they cannot both stand together, then the State legislation will be said to be repugnant to the Parliamentary legislation. However, if the State legislation or part thereof deals not with the matters which formed the subject matter of Parliamentary legislation but with other and distinct matters though of a cognate and allied nature, there is no repugnancy.”*²⁰

Applying these principles to the facts of the case at hand, the Court held that the Maharashtra Relief Undertakings (Special Provisions) Act, 1958 was repugnant to the Code since a consolidating and amending act like the Code *“forms a code complete in itself and is exhaustive of the matters dealt with therein”*²¹ and *“In the present case it is clear, therefore, that unless the Maharashtra Act is out of the way, the Parliamentary enactment will be hindered and obstructed in such a manner that it will not be possible to go ahead with the insolvency resolution process outlined in the Code.”*²² Further the Court also referenced section 238 of the Code and held that *“It is clear that the later non-obstante clause of the Parliamentary enactment will also prevail over the limited non- obstante clause contained in Section 4 of the Maharashtra Act.”*²³

The principles of this case would be instructive for other cases where there is inconsistency between a state legislation and the Code as well.

Conclusion

The question of inconsistencies of other legislation with the Code is to be evaluated on a case-by-case basis, keeping in mind the provisions of the legislations. Given that the Code is a special law that is intended to be a complete code dealing with insolvency and bankruptcy, and has an overriding provision, it is likely that the provisions of the Code will prevail over previously enacted inconsistent State law.

²⁰ *Ibid.*

²¹ *Ibid.*

²² *Ibid.*

²³ *Ibid.*

The Concept of “Operational Debt” and “Financial Debt” under the Corporate Insolvency Resolution Process

Introduction

A company has different types of creditors each of whom have different rights and motivations. Accordingly, when insolvency resolution commences, their concerns are different, and may have to be accounted for differently. Thus, typically insolvency regimes make accommodation for different creditors.²⁴

In India, the Code recognises three different types of creditors: financial creditors, operational creditors and other creditors. Each of these have been given different rights and powers. Accordingly, it becomes relevant to determine which types of debt would be classified as financial, operational or other debt.

Analysis

The term financial debt has been defined in section 5(8) of Code “to mean a debt, alongwith interest, if any, which is disbursed against the consideration for the time value of money.” An illustrative list of transactions that would fall under this definition has also been included. Typically financial creditors are those “whose relationship with the entity is a pure financial contract, such as a loan or a debt security. Operational creditors are those whose liability from the entity comes from a transaction on operations.”²⁵ However, following the recommendations of the Insolvency Law Committee, homebuyers have also been deemed to be financial creditors under the Code.²⁶ If a creditor is a financial creditor, it has the ability to initiate the insolvency resolution process, the ability to make claims in this process, and the right to be a voting member of the committee of creditors that accepts or rejects a resolution plan.

Section 5(20) of the Code defines an operational debt as “a claim in respect of the provisions of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority”. Operational creditors are those whose claims arise “from a transaction on operations. Thus, the wholesale vendor of spare parts whose spark plugs are kept in inventory by car mechanics and who gets paid only after the spark plugs are sold is an operational creditor. Similarly, the lessor that the entity rents out space from is an operational creditor to whom the entity owes monthly rent on a three-year lease.”²⁷ An operational creditor has the right to file an application to initiate the insolvency resolution process of a corporate debtor, to file a claim in the insolvency resolution process and to participate, without voting rights, in a committee of creditors through their representatives.

In *Swiss Ribbons Ltd. v. Union of India*,²⁸ the Court laid down the distinction between ‘Financial Debt’ and ‘Operational Debt’ in the following terms, “A perusal of the definition of ‘financial creditor’ and ‘financial debt’ makes it clear that a financial debt is a debt together with interest, if any, which is disbursed against the consideration for time value of money. It may further be money that is borrowed or raised in any of the manners prescribed in Section 5(8) or otherwise, as Section 5(8) is an inclusive definition. On the other hand, an ‘operational debt’ would include a claim in respect of the provision of goods or services, including employment, or a debt in respect of payment of dues arising under any law and payable to the Government or any local authority.” The Court also commented on the distinction between the nature of the agreement with a financial creditor and the nature of the agreement with an

²⁴ For instance, secured creditors are typically given a special status in regimes across the world.

²⁵ Bankruptcy Law Reform Committee, *Report of the Bankruptcy Law Reform Committee*, Para 5.2.1 Vol. I (2015).

²⁶ Section 5(8)(f), Code.

²⁷ Bankruptcy Law Reform Committee, *Report of the Bankruptcy Law Reform Committee*, Para 5.2.1 Vol. I (2015).

²⁸ *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India*, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019.

operational creditor by observing that the “financial creditors generally lend finance on a term loan or for working capital that enables the corporate debtor to either set up and/or operate its business. On the other hand, contracts with operational creditors are relatable to supply of goods and services in the operation of business. Financial contracts generally involve large sums of money. By way of contrast, operational contracts have dues whose quantum is generally less.”

Financial debt

In determining what constitutes financial debt, there has been lack of clarity on what constitutes “time value of money”. This was interpreted most notably in *Nikhil Mehta v AMR Infrastructure*.²⁹ The main issue in this case was whether investors in real estate, in favour of whom assured returns were stipulated (as per their contracts) could be considered financial creditors. In holding that such investors would not be considered financial creditors, the NCLT in this case opined that “the first essential requirement of financial debt has to be met viz, that the debt is disbursed against the consideration for the time value of money and which may include the events enumerated in various sub-clauses... The key feature of financial transaction as postulated by section 5(8) is its consideration for time value of money. In other words, the legislature has included such financial transactions in the definition of 'Financial debt' which are usually for a sum of money received today to be paid for over a period of time in a single or series of payments in future. It may also be a sum of money invested today to be repaid over a period of time in a single or series of instalments to be paid in future. In Black's Law- Dictionary (9th edition) the expression 'Time Value' has been defined to mean "the price associated with the length of time that an investor must wait until an investment matures or the related income is earned". In both the cases, the inflows and outflows are distanced by time and there is a compensation for time value of money...” These observations were approved by the NCLAT in an appeal in the same case.³⁰

In other cases too, the concept of time value of money has been examined. Most notably, in *Uttam Galva*,³¹ the NCLT clarified that “business always runs keeping in mind the time value for money... transaction will be operational if payment is to goods or services, transaction is financial if money is lent in contemplation of returns in the form of interest”. Thus, merely because an operational creditor claims interest for a delayed payment does not mean the claim becomes a claim for financial debt. The intent of the parties, viz., advancing of money for financial returns, or supply of goods and services. may be looked at in ascertaining if a debt is financial or not.

However, lending for the time value of money does not mean that the debt should bear interest. In *Shailesh Sangani v. Joel Cardoso*,³² the NCLAT while analysing the definition of ‘financial debt’, held that as per definition provided under section 5(8), interest is not a *sine qua non* for a debt to be classified as ‘financial debt’. What is important is that the amount was disbursed against the time value of money, with or without bearing interest. The Appellate Tribunal further observed that “Clauses (a) to (i) of Section 5(8) embody the nature of transactions which are included in the definition of ‘financial debt’. It includes money borrowed against the payment of interest. Clause (f) of Section 5(8) specifically deals with amount raised under any other transaction having the commercial effect of a borrowing which also includes a forward sale or purchase agreement. It is manifestly clear that money advanced by a Promoter, Director or a Shareholder of the Corporate Debtor as a stakeholder to improve financial health of the Company and boost its economic prospects, would have the commercial effect of borrowing on the part of Corporate Debtor notwithstanding the fact that no provision is made for interest thereon.”

Operational debt

In determining what constitutes operational debt, there has been lack of clarity on what the scope of the term would be and whether it would include all debts other than financial debts. In *Col. Vinod Awasthy v. AMR Infrastructure Limited*,³³ the NCLT interpreted the definition of ‘operational creditor’ under the Code. The NCLT observed that the framers of the Code had not proposed to include within the expression of an ‘operational

²⁹ *Nikhil Mehta & Sons (HUF) &Ors. v. AMR Infrastructure Ltd.*, C.P. No. (ISB)-O3(PB)/2017. Decision date- 23.01.2017

³⁰ *Nikhil Mehta and Sons v. AMR Infrastructure Ltd.*, Company Appeal (AT) (Insolvency) No. 07 of 2017. Decision date- 21.07.2017

³¹ *DF Deutsche Forfait AG and Ors v. Uttam Galva Steel Ltd.*, C.P. No. 45/I&BP/NCLT/MAH/2017. Decision date- 10.04.2017

³² *Shailesh Sangani v. Jolel Cardoso*, Company Appeal (AT) (Insolvency) No.616 of 2018. Decision date- 30.01.2019.

³³ *Col. Vinod Awasthy v. AMR Infrastructure Limited*, C.P. No. (IB)10(PB)/2017. Decision date- 20.02.2017

debt', a debt other than a financial debt.³⁴ Therefore, an operational debt would be related only to four categories as specified in section 5(21) of the Code like goods, services, employment and Government dues. A similarly strict approach to interpreting this section was exhibited in the cases of *Mukesh Kumar v. AMR Infrastructure Limited*³⁵ and *Pawan Dubey and Another v. J.B.K. Developers Private Limited*.³⁶

However, the term has been interpreted more broadly on a case-to-case basis. For instance, in *Renish Petrochem FZE v. Ardor Global Private Limited*,³⁷ where the issue for consideration was whether a guarantor can be considered as Corporate Debtor in case of claim by an operational creditor, the NCLT, held that “*the amount due from the buyer of the goods, and which is due to the seller of the goods and is guaranteed by the Guarantee Agreement, is also an ‘operational debt’*”.

Other debts

Those debts that are neither operational nor financial are considered other debts. While there were no specific provisions in the Code guaranteeing rights to such creditors to initiate or control the insolvency resolution process, the Insolvency and Bankruptcy Board of India, through an amendment to the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, has enabled ‘other creditors’ to file claims in the process.

Conclusion

The key criteria to determine if a debt is a financial debt is if it was extended for time value of money. On the other hand, a debt would be operational debt only if it relates to the four categories: goods, services, employment and Government dues. Debts other than these would be classified as other debts. The rights and powers of relevant creditors of each of these different categories of debts are different and thus classification of debts is key in the corporate insolvency resolution process.

³⁴ See also: *Mr. Sanjeev Jain v. M/S Eternity Infracon*, CP No. (IB)- 113(ND)/2017. Decision Date- 12.07.2017

³⁵ *Mukesh Kumar v. AMR Infrastructure Limited*, C.P. No. (IB)-30(PB)/2017. Decision date- 31.03.2017

³⁶ *Pawan Dubey and Another v. J.B.K. Developers Private Limited*, C.P. No. (IB)- 19(PB)/2017. Decision date- 16.02.2018

³⁷ *Renish Petrochem FZE v. Ardor Global Private Limited*, C.P. (I.B) No. 33/9/NCLT/AHM/2017. Decision date- 31.07.2017

Timelines under the Code

Introduction

One of the aims of an insolvency law is to maximize the value of the assets of the corporate debtor. Value is usually dependent on the time taken to resolve the insolvency, since it erodes over time, and rapidly once formal insolvency proceedings commence. There are concerns that delays may make reorganization impossible, and may induce liquidation, causing value destruction. Further, even in liquidation, delays lower recoveries.

Where the insolvency regime facilitates a restructuring based on negotiations with creditors, the concern is that delaying tactics will extend the time set for negotiations at the start.³⁸ Another source of delay could lie in adjudicatory mechanisms, and delay in passing orders relevant for the resolution of insolvency.

In the Indian landscape, this becomes particularly pertinent due to the experience under the Sick Industrial Companies Act, 1985. Accordingly, it is relevant to analyse the jurisprudence and provisions of the Code that are aimed at improving timeliness of proceedings under the Code.

Analysis

The Preamble of the Code states that it is “An Act to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner...” To enable this, detailed timelines have been prescribed in the Code.

At the stage of admission of an application for initiating insolvency proceedings, the Code provides 14 days’ time to the NCLT to make a decision regarding admission or rejection. Before rejecting an application, the NCLT is required to provide 7 days’ time to the applicant to rectify defects, if any, in the application. There was lack of clarity on whether this was mandatory or directory. In *JK Jute Mills Company Ltd. v. M/s Surendra Trading Company*,³⁹ the NCLAT held that time is of the essence under the Code, which requires the NCLT and all stakeholders to perform within the time limits prescribed except in exceptional circumstances. However, the NCLAT held that the 14 days’ timeline is a directive, and the NCLT has inherent powers to extend the 14-day period on a case-to-case basis in the interest of fairness and justice. It further observed that the 7 days’ time period provided for rectification of defects would have to be mandatorily complied with and no concession could be granted in this regard. On appeal, the Supreme Court⁴⁰ confirmed the conclusion that the fourteen day period would be directory and also set aside part of this order by holding that the 7 days’ period would also be directory in nature, given that “it is well-settled principle of law that where a statutory functionary is asked to perform a statutory duty within the time prescribed therefor, the same would be directory and not mandatory.”

Apart from the timeline given for admission of cases, the Code also provides a strict timeline for the completion of the entire resolution process. Section 12 of the Code states that

“(1) Subject to sub-section (2), the corporate insolvency resolution process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate such process.

(2) The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of sixty-six per cent of the voting shares.

³⁸ Bankruptcy Law Reform Committee, *Report of the Bankruptcy Law Reform Committee*, Vol. 1 (2015)

³⁹ *JK Jute Mills Company Ltd. v. M/s Surendra Trading Company*, Company Appeal (AT) No. 09 of 2017. Decision date- 01.05.2017

⁴⁰ *Surendra Trading Company v. JuggilalKamlapat Jute Mills Company Limited &Ors.*, Civil Appeal No. 8400 of 2017. Decision date- 19.09.2017

(3) On receipt of an application under sub-section (2), if the Adjudicating Authority is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within one hundred and eighty days, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but not exceeding ninety days:

Provided that any extension of the period of corporate insolvency resolution process under this section shall not be granted more than once."

After the expiry of 180 days (or 270 days as the case may be), in the event a resolution plan has not been submitted, or if submitted, and rejected under section 31 of the Code or even after the dismissal of an appeal filed under section 61 contesting rejection of a plan, the Code directs that the debtor initiate a liquidation process.⁴¹

The time period prescribed by the Code is the maximum time provided for the completion. There may be instances, where a resolution process can be completed before the maximum time period prescribed. In *Prowess International Pvt. Ltd. v. Parker Hannifin India Pvt. Ltd.*,⁴² the NCLAT observed that *"thereafter, in case(s) where all creditors have been satisfied and there is no default with any other creditor, the formality of submission of resolution plan under section 30 or its approval under section 31 is required to be expedited on the basis of plan if prepared. In such case, the Adjudicating Authority without waiting for 180 days of resolution process, may approve resolution plan under section 31, after recording its satisfaction that all creditors have been paid/ satisfied and any other creditor do not claim any amount in absence of default and required to close the Insolvency Resolution Process. On the other hand, in case the Adjudicating Authority do not approve resolution plan, will proceed in accordance with law."*

Where the whole period of 180 days passes and the Adjudicating Authority is satisfied that the process cannot be completed during the given time period, it may extend the period by up to 90 days. While the Code states that no further extension may be given after this period, there was a concern that this maximum timeline may also be extended by courts.⁴³ However, the Supreme Court in *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta*⁴⁴ unequivocally held that the entire time period within which the corporate insolvency resolution process ought to be completed is strictly mandatory in nature, and cannot be extended. It relied on the primary objective of the Code, which is to ensure a timely resolution process for a corporate debtor, and principles of statutory interpretation to hold that the literal language of section 12 mandates strict adherence to the time frame it lays down. To enable this adherence to the outer time limit provided in the Code, the court also held that the model timeline provided in Regulation 40A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 should be followed "as closely as possible".

It is relevant to note, however, that while the statutory outer time limit cannot be extended, this does not apply to the internal timelines for the processes set by the committee of creditors, as long as those are within the statutory outer time limit. In *Tata Steel Limited v. Liberty House*,⁴⁵ the Appellate Tribunal on going through the clauses of the 'Process Document', held that the Committee of Creditors has the discretion to update, amend, modify, supplement, add, delay, cease or annul the resolution process at any time and *"the 'Resolution Professional' in consultation with the 'Committee of Creditors' can extend the timelines at its sole discretion if expedient for obtaining the best 'Resolution Plan' for the Company. Therefore, granting more opportunity to all the eligible 'Resolution Applicants' to revise its 'financial offers', even by giving more opportunity, is permissible in the Law. However, all such process should complete within the time frame."*

⁴¹ Section 33, Code

⁴² *Prowess International Pvt. Ltd. v. Parker Hannifin India Pvt. Ltd.*, Company Appeal (AT) (Insol.) No. 89 of 2017. Decision date- 18.08.2017

⁴³ See: *RBL Bank Limited. v. MBL Infrastructure Limited*, CA (IB) Nos. 238, 270 & 288/KB/2018 in CP (IB) No. 170/KB/2017. Decision date- 18.04.2018 In this case the Kolkata Bench of the NCLT observed that *"it appears to us that even in a case if we are satisfied that grave injustice would be occurred if a prayer for extension for no fault of applicant is occurred the Adjudicating Authority can extend the time limit provided under section 12 of the Code. However we are not asked to extend the time limit as provided under section 12 of the Code but to exclude the period due to litigation... So we are not holding that we can extend the period of CIRP as prescribed under section 12 of the Code."*

⁴⁴ *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta & Ors.*, C.A. Nos. 9402-9405 of 2017. Decision date- 04.10.2018

⁴⁵ *Tata Steel Limited v. Liberty House Group Pte. Ltd.*, Company Appeal (AT) (Insolvency) No. 198 of 2018. Decision date- 04.02.2019

Even where the statutory outer time limit cannot be extended, questions arise as to whether certain periods can be excluded from the calculation of the maximum time. The NCLAT in *Quinn Logistics v. Mack Soft Tech*⁴⁶ gave an illustrative list of the time-gaps that may be excluded:

"From the decisions aforesaid, it is clear that if an application is filed by the 'Resolution Professional' or the 'Committee of Creditors' or 'any aggrieved person' for justified reasons, it is always open to the Adjudicating Authority/Appellate Tribunal to 'exclude certain period' for the purpose of counting the total period of 270 days, if the facts and circumstances justify exclusion, in unforeseen circumstances.

10. For example, for following good grounds and unforeseen circumstances, the intervening period can be excluded for counting of the total period of 270 days of resolution process:-

(i) If the corporate insolvency resolution process is stayed by 'a court of law or the Adjudicating Authority or the Appellate Tribunal or the Hon'ble Supreme Court.

(ii) If no 'Resolution Professional' is functioning for one or other reason during the corporate insolvency resolution process, such as removal.

(iii) The period between the date of order of admission/moratorium is passed and the actual date on which the 'Resolution Professional' takes charge for completing the corporate insolvency resolution process.

(iv) On hearing a case, if order is reserved by the Adjudicating Authority or the Appellate Tribunal or the Hon'ble Supreme Court and finally pass order enabling the 'Resolution Professional' to complete the corporate insolvency resolution process.

(v) If the corporate insolvency resolution process is set aside by the Appellate Tribunal or order of the Appellate Tribunal is reversed by the Hon'ble Supreme Court and corporate insolvency resolution process is restored.

(vi) Any other circumstances which justifies exclusion of certain period. However, after exclusion of the period, if further period is allowed the total number of days cannot exceed 270 days which is the maximum time limit prescribed under the Code."

Following this, the NCLAT in *Velamur Varadan Anand v. Union Bank of India & Anr.*⁴⁷ allowed the exclusion of time from calculation of the maximum time limit since the resolution professional had not taken charge for almost thirty days.

The Supreme Court in *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta*⁴⁸ specifically dealt with the issue of whether the time taken in litigation could be excluded from the outer time limit provided in the Code, and held that it could. The court opined that "A reasonable and balanced construction of this statute would therefore lead to the result that, where a resolution plan is upheld by the Appellate Authority, either by way of allowing or dismissing an appeal before it, the period of time taken in litigation ought to be excluded. This is not to say that the NCLT and NCLAT will be tardy in decision making. This is only to say that in the event of the NCLT, or the NCLAT, or this Court taking time to decide an application beyond the period of 270 days, the time taken in legal proceedings to decide the matter cannot possibly be excluded, as otherwise a good resolution plan may have to be shelved, resulting in corporate death, and the consequent displacement of employees and workers." The Court did not deal with the issue of exclusions due to the other reasons mentioned in *Quinn*.

However, in *Ajay Agarwal v. AML Steel & Power Ltd.*,⁴⁹ an appeal was made against the impugned order of the Adjudicating Authority allowing the exclusion of 90 days from the corporate insolvency resolution period on the ground that company premises were located in a Naxalite infested area because of which the Resolution

⁴⁶ *Quinn Logistics India Pvt. Ltd. v. Mack Soft Tech Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 185 of 2018. Decision Date- 08.05.2018

⁴⁷ *Velamur Varadan Anand v. Union Bank of India & Anr.*, Company Appeal (AT) (Insolvency) No. 161 of 2018. Decision Date- 16.05.2018

⁴⁸ *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta & Ors.*, C.A. Nos. 9402-9405 of 2017. Decision date- 04.10.2018

⁴⁹ *Ajay Agarwal v. Shantanu T. Ray, RP of AML Steel and Power Ltd. & Ors.*, Company Appeal (AT) (Insolvency) No. 61 of 2019. Decision date- 18.01.2019.

Profession was finding it difficult to visit the premises without police assistance. The NCLAT upheld the impugned order stating that the order is in tune with the position laid down in *Quinn Industries* regarding the grounds that warrant exclusion of time from the corporate insolvency resolution process.

Conclusion

The Code stipulates fixed timelines to ensure timely resolution for corporate debtors, for the benefit of all stakeholders. Judicial interpretation has, by and large, promoted this objective by mandating that various parts of the timeline be adhered to and mandating that the outer time-limit provided in section 12 cannot be extended. However, certain time periods may be excluded from the calculation of the total time periods for the insolvency resolution process, including time taken in litigation.

Decoding “Dispute” under the Corporate Insolvency Resolution Process

Introduction

The initiation of formal insolvency proceedings against a debtor results in significant costs to it and all its stakeholders. For instance, in India, there is a moratorium on enforcement actions, there is suspension of the powers of the board of directors and the creditors exercise control through an insolvency professional, all of which affect the rights of the debtor and the stakeholders. In some instances, the initiation of formal proceedings could also reduce the value of the debtor’s assets because it signals the distress of the debtor. Accordingly, the decision to put a company through insolvency should be taken only when there is genuine distress that needs resolution, and not when there are deep disputes about the existence of that distress. On the other hand, when there is scope to dispute various facts before an insolvency process can be started, it can lead to delays that reduce the value of assets and lower the possibility of resolving insolvency effectively.

Consequently, an insolvency law must provide the ability to dispute the existence of insolvency, but put in place safeguards to ensure that these cannot be used frivolously to delay the insolvency resolution process.

Analysis

As per section 9 of the Code, an operational creditor who wishes to file an application to initiate the corporate insolvency resolution process against the corporate debtor before the Adjudicating Authority must comply with section 8(1) of the Code. As per section 8(1), “An operational creditor may deliver a demand notice of unpaid operational debt or a copy of an invoice demanding payment of an amount involved in the default to the corporate debtor...” In response to the demand notice or invoice, “the corporate debtor shall, within a period of ten days of the receipt of the demand notice or copy of the invoice mentioned in sub-section (1) bring to the notice of the operational creditor—

- (a) *existence of a dispute, if any, and record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute;” (Section 8(2))...*

Section 5(6) of the Code, provides that the term ‘dispute’ “includes a suit or arbitration proceedings relating to –

- (a) *the existence of the amount of debt;*
- (b) *the quality of goods or service; or*
- (c) *the breach of a representation or warranty”*

Vis-à-vis operational creditors, therefore, the Code provides a mechanism for the corporate debtor to specifically raise a dispute. This can be used to prevent the admission of a petition to initiate an insolvency resolution process. However, there has been a lack of clarity on the scope of the term dispute, and on the point at which a dispute should have been raised.

Different benches of the NCLT provided conflicting interpretations to the terms ‘dispute’ and ‘existence of dispute’. The Mumbai Bench gave a strict interpretation to the terms,⁵⁰ and observed that the word ‘includes’ should be read as ‘means’, and consequently, a dispute would mean disputes raised in a court of law or Arbitral Tribunal before receipt of notice under section 8 of the Code. On the other hand, the Principal Bench provided a

⁵⁰ *Essar Projects India Ltd. v. MCL Global Steel Pvt. Ltd., 2017 (4) TMI 1156. Decision date- 06.03.2017, DF Deutsche Forfait AG and Ors v. Uttam Galva Steel Ltd., C.P. No. 45/I&BP/NCLT/MAH/2017. Decision date- 10.04.2017*

very liberal interpretation to the terms in question in a catena of cases,⁵¹ and held that the definition of dispute is illustrative in nature and any dispute raised post issuance of a demand notice, whether before a court of law/competent authority or otherwise, could also be considered as a valid dispute.

The NCLAT took a similar view as the Principal Bench of the NCLT in *Kirusa Software Pvt. Ltd. v. Mobilox Innovations Pvt. Ltd.*⁵² and provided a liberal interpretation to the phrases 'dispute' and 'existence of dispute'. The NCLAT held that the definition of "dispute" is "inclusive" and not "exhaustive" and includes mediation, conciliation, labour court, consumer court or any other proceedings pending or raised before any court of law or authority. The NCLAT also held that the dispute need not be pending between the parties prior to the notice of demand, but could be raised thereafter. Significantly, it also clarified that Adjudicating Authority need not verify the adequacy of dispute. It only needs to be satisfied that a genuine dispute exists.

This matter was finally settled by the Supreme Court in *Mobilox Innovations Pvt. Ltd. v. Kirusa Software Pvt. Ltd.*⁵³ The Court held that the definition of dispute is an inclusive one and also held that it would not be necessary for the dispute to be pending before the filing of the application since "*a dispute may arise a few days before triggering of the insolvency process, in which case, though a dispute may exist, there is no time to approach either an arbitral tribunal or a court.*" To determine if the dispute exists, the court held that "*all that the adjudicating authority is to see at this stage is whether there is a plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence...The Court does not at this stage examine the merits of the dispute except to the extent indicated above. So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the Adjudicating Authority has to reject the application.*"⁵⁴ By virtue of the Second Amendment to the Code,⁵⁵ the decision in *Mobilox* was given statutory recognition.

This decision has thereafter been applied in context of arbitration proceedings by the Supreme Court itself. In *K. Kishan v. Vijay Nirman Company Pvt. Ltd.*,⁵⁶ the Court held that "*operational creditors cannot use the Insolvency Code either prematurely or for extraneous considerations or as a substitute for debt enforcement procedures. The alarming result of an operational debt contained in an arbitral award for a small amount of say, two lakhs of rupees, cannot possibly jeopardize an otherwise solvent company worth several crores of rupees. Such a company would be well within its rights to state that it is challenging the Arbitral Award passed against it, and the mere factum of challenge would be sufficient to state that it disputes the Award. Such a case would clearly come within para 38 of Mobilox Innovations (supra), being a case of a pre-existing ongoing dispute between the parties.*"⁵⁷ Further, the Court stated that "*the object of the Code, at least insofar as operational creditors are concerned, is to put the insolvency process against a corporate debtor only in clear cases where a real dispute between the parties as to the debt owed does not exist.*"⁵⁸

While this has clarified the existence of dispute in respect of operational creditors, there has also been lack of clarity as to the position of financial creditors where there is a dispute as to the existence of a claim. The Code does not specifically have any provision that deals with the existence of a dispute in respect of a financial debt, since there is an expectation that information utilities would be able to provide undisputed information regarding the existence of a debt or default.⁵⁹

⁵¹ *One Coat Plaster and Shivam Construction Company v. Ambience Private Ltd.* C.P. No. (I.B.) 07/PB/2017. Decision date- 01.03.2017; *Annapurna Infrastructure Pvt. Ltd. & Ors. v. Soril Infra Resources Ltd.*, CP. No. (IB)-22(PB)/2017. Decision date- 24.03.2017; *Goodwill Hospital and Research Centre Ltd v. Philips India Limited* CP No. (IB)-03(PB)/2017. Decision date- 02.03.2017; *K. K. V. Naga Prasad v. Lanco Infratech Ltd.* CP No. (IR) No. 9/9HDR/2017. Decision date- 13.07.2017

⁵² *Kirusa Software Pvt. Ltd. v. Mobilox Innovations Pvt. Ltd.*, Company Appeal (AT) (Insolvency) 6 of 2017. Decision date- 24.05.2017

⁵³ *Mobilox Innovations Pvt. Ltd. v. Kirusa Software Pvt. Ltd.*, Civil Appeal No. 9405 of 2017. Decision date- 21.09.2017

⁵⁴ *Mobilox Innovations Pvt. Ltd. v. Kirusa Software Pvt. Ltd.*, Civil Appeal No. 9405 of 2017. Decision date- 21.09.2017

⁵⁵ Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, available at [http://ibbi.gov.in/webadmin/pdf/whatsnew/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20\(Second%20Amendment\)%20Act,%202018_2018-08-18%2018:42:09.pdf](http://ibbi.gov.in/webadmin/pdf/whatsnew/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20(Second%20Amendment)%20Act,%202018_2018-08-18%2018:42:09.pdf)

⁵⁶ *K. Kishan v. Vijay Nirman Company Pvt. Ltd.*, Civil Appeal Nos. 21824 and 21825 of 2017. Decision date - 14.08.2018

⁵⁷ *Ibid.*

⁵⁸ *Ibid.*

⁵⁹ Bankruptcy Law Reform Committee, *Report of the Bankruptcy Law Reform Committee*, Para 5.2.1 Vol. I (2015)

However, the Supreme Court in *Innoventive Industries v. ICICI Bank*,⁶⁰ held that “at the stage of Section 7(5), where the adjudicating authority is to be satisfied that a default has occurred, that the corporate debtor is entitled to point out that a default has not occurred in the sense that the “debt”, which may also include a disputed claim, is not due. A debt may not be due if it is not payable in law or in fact.” Accordingly, a corporate debtor could also dispute the existence of a financial debt. This was also relied on by the Supreme Court in *Mobilox*,⁶¹ where the court held that while the scheme for disputing financial debts and operational debts was different, a dispute could be raised in respect of a financial debt as well. A corporate debtor could show that the debt was a disputed claim, the debt was not due or there was no default. It is relevant to note, however, that this takes place when the Adjudicating Authority is making an order admitting the application. This is distinct from the scheme of raising a dispute for operational debts which has been designed keeping in mind that “operational debts also tend to be recurring in nature and the possibility of genuine disputes in case of operational debts is much higher when compared to financial debts.”⁶²

Conclusion

The Supreme Court has held that corporate debtors can dispute the initiation of insolvency proceedings against them both in respect of operational debts and financial debts. In respect of operational debts, the Code specifically defines the term “dispute” and gives corporate debtors a chance to raise a dispute. These disputes need not be restricted to a disputes raised in suits or arbitration proceedings. In addition, these disputes need not be raised prior to the filing of the application, but may be raised thereafter as well. The Adjudicating Authority, while assessing if there is a dispute must only analyse if the dispute exists in fact, and is not illusory.

⁶⁰M/s Innoventive Industries Ltd. v. ICICI Bank, Civil Appeal Nos. 8337-8338 of 2017. Decision date- 31.08.2017

⁶¹Mobilox Innovations Pvt. Ltd. v. Kirusa Software Pvt. Ltd., Civil Appeal No. 9405 of 2017. Decision date- 21.09.2017

⁶²Swiss Ribbons Pvt. Ltd. &Anr. v. Union of India, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019

Right of Hearing on Admission of an Application under the Code

Introduction

The Code was enacted with the purpose of maximising the value of the assets of the debtor in the interest of all stakeholders. An important facet of maximising value is reducing the time taken to resolve insolvency. To this end, the scheme of the Code is designed to preserve judicial time and reduce judicial discretion. The Adjudicating Authority's "main objective is to ensure that the insolvency or bankruptcy resolution is being performed within the framework laid down by the law."⁶³

The Adjudicating Authority for the corporate insolvency processes is the NCLT or NCLAT. While these Tribunals administer the provisions of the Code, they have been constituted under the Companies Act, 2013. While these Tribunals are not bound by the rules of procedure prescribed under the Civil Procedure Code, 1973, the Companies Act, 2013 requires them to be guided by the principles of natural justice while disposing of proceedings before them.⁶⁴

Analysis

At the start of the corporate insolvency resolution process, the Adjudicating Authority admits an application for initiating the corporate insolvency resolution process.

Sections 7, 9 and 10 of the Code prescribe the procedure for initiation of the corporate insolvency resolution process. While these sections do not explicitly provide a right of hearing, the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 stipulate that the applicant dispatch a copy of the application to the corporate debtor.⁶⁵ The observance of this rule has been held to be mandatory in nature and not discretionary in a plethora of cases. In *Innoventive Industries*, the NCLAT held that, "...we hold that the Adjudicating Authority is bound to issue a limited notice to the corporate debtor before admitting a case for ascertainment of existence of default based on material submitted by the corporate debtor."⁶⁶ In *Starlog Enterprises Limited vs. ICICI Bank Limited*, NCLAT refused to uphold the decision passed by NCLT as it had failed to issue a notice to the debtor before admitting the application, branding it a "...violation of principle of natural justice."⁶⁷ The NCLAT in another case declined to uphold a decision encompassing a penalty levied by the NCLT as the same was done without serving any notice to the concerned party.⁶⁸

While the provisions in the Rules facilitate notice to the corporate debtor, the constitutionality of sections 7 and 9 of the Code was challenged on the grounds that they do not provide the right to be heard. In this regard, the NCLAT in *Innoventive*,⁶⁹ held that it would not be possible to exclude the applicability of principles of natural justice to "the insolvency resolution process as it is not a case of emergency declared or prejudicial to public interest or that there is a statutory exclusion of rules of natural justice or it is impracticable to hold hearing." The NCLAT also emphasised that the insolvency resolution process would affect the rights of persons since the initiation of the process the Board of Directors stands suspended and its powers vest with the interim resolution professional, and other persons are affected due to the moratorium, and consequently, "the 'adjudicating authority' is duty

⁶³ Bankruptcy Law Reform Committee, *Report of the Bankruptcy Law Reform Committee*, Vol 1 (2015), Para 4.2

⁶⁴ Section 424, Companies Act, 2013

⁶⁵ Rule 4(3) and 6(2), Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016

⁶⁶ *Innoventive Industries Ltd. v. ICICI Bank and Ors.*, Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017. Decision date - 15.05.2017

⁶⁷ *Starlog Enterprises Limited v. ICICI Bank Limited*, Company Appeal (AT) (Insolvency) No. 5 of 2017. Decision date - 24.05.2017

⁶⁸ *Unigreen Global Private Limited v. Punjab National Bank and Ors.*, Company Appeal (AT) (Insolvency) No. 81 of 2017. Decision date - 01.12.2017

⁶⁹ *Innoventive Industries Ltd. v. ICICI Bank and Ors.*, Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017. Decision date - 15.05.2017

bound to give a notice to the corporate debtor before admission of a petition under Section 7 or Section 9.” It reiterated this view in its order in the case of *Starlog Enterprises*, and held that “...an insolvency resolution process can and may have adverse consequences on the welfare of the company. This makes it imperative for the 'adjudicating authority' to adopt a cautious approach in admitting insolvency applications and also ensuring adherence to the principles of natural justice.”⁷⁰

Moreover, the Calcutta High Court in *Sree Metaliks*⁷¹ has held that if a specific statute does not expressly rule out the application of principles of natural justice, or is silent regarding it, the same “can and should be read into it.”⁷² This position has been reaffirmed by the High Court by its decision in *Akshay Jhunjunwala*.⁷³ This principle has also been applied by the Karnataka High Court. In *Falcon Tyres v. Edelweiss Asset Reconstruction Company*,⁷⁴ the Karnataka High Court held that the NCLT must hear both parties before admitting an application for initiation of the insolvency resolution process under the Code.

This issue has now been laid to rest with the decision of the Supreme Court in *Swiss Ribbons* where the court has clarified that for the admission of an application to initiate an insolvency resolution process, the Adjudicating Authority has to satisfy itself that there is default or non-payment of operational debt. For this, the Adjudicating Authority has to “issue notice to the corporate debtor, hear the corporate debtor, and then adjudicate upon the same.”⁷⁵

Conclusion

At the time of admitting an application to initiate the corporate insolvency resolution process, the Adjudicating Authority must provide a right of hearing to the corporate debtor in consonance with the principles of natural justice

⁷⁰ *Starlog Enterprises Limited v. ICICI Bank Limited, Company Appeal (AT) (Insolvency) No. 5 of 2017. Decision date - 24.05.2017*

⁷¹ *SreeMetaliks Ltd. v. Union of India, Writ Petition 7144 (W) of 2017. Decision date- 07.04.2017*

⁷² *Ibid.*

⁷³ *AkshayJhunjunwala and Anr. v. Union of India, Writ Petition No. 627 of 2017. Decision date- 02.02.2018*

⁷⁴ *Falcon Tyres Ltd. v. Edelweiss Asset Reconstruction Company, Writ Petition No. 16486/ 2017. Decision date- 05.06.2017*

⁷⁵ *Swiss Ribbons Pvt. Ltd. &Anr. v. Union of India, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019*

Supply of Critical Goods and Services during the Corporate Insolvency Resolution Process

Introduction

A key element of a modern corporate insolvency resolution processes is the provision of 'breathing space' to a debtor to enable assessment of its viability and sale of its assets or restructuring of its debts.⁷⁶ In this period, therefore, the aim is to help businesses continue trading while a resolution that maximizes value for all creditors is reached.

To enable this, it is key that critical suppliers, without the supply of whose goods and services the debtor cannot function, continue their supplies without interruption. Thus, for the orderly completion of the insolvency resolution process, insolvency laws may have some provisions that enable the continuation of the supply of such goods and services. There is a need to examine how the continuation of such supplies is enabled under the Code.

Analysis

Insolvency proceedings under the Code typically involve two kinds of critical supplies, (a) non-input 'essential goods and services' covered by section 14(2) and (b) other critical supplies. Supply of essential goods and services, as defined in the Regulations, is mandated under section 14(2) of the Code. Supply of critical supplies other than those covered under the definition of 'essential goods and services', is not mandated but has to be negotiated and secured by the resolution professional.

(a) Essential goods and services covered by section 14(2)

Section 14(2) of the Code states that when an order initiating the corporate insolvency resolution process is passed, the *"The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period."* The term "essential goods and services" has been defined by the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 to mean electricity, water, telecommunication services and information technology services to the extent these are not a direct input to the output produced or supplied by the corporate debtor. To illustrate, the Regulations specify that *"water supplied to a corporate debtor will be essential supplies for drinking and sanitation purposes, and not for generation of hydro-electricity."* In other words, supplies constituting input for a finished product or services are not mandated. Thus, during the moratorium, section 14 of the Code (read with the Regulations) mandates the uninterrupted supply of only those specified goods and services which do not constitute a direct input for a finished product or service.

The Mumbai Bench of the NCLT in *ICICI Bank v. Innoventive Industries*,⁷⁷ explained this position as follows *"By reading this Regulation, it appears that electricity, water and telecommunication services and Information Technology service are to be considered as essential as long as these services are not a requirement to the output produced or supplied by the Corporate Debtor. Under this regulation, an illustration also been given saying that water is to be considered as essential service as long as it is used for drinking purpose and sanitization purpose but not for generating electricity. Whenever any illustration is given, it will be given to have an understanding about the provision of law. If supply of water for drinking and sanitization purpose is an essential service, the supply of electricity is also deemed to be limited for lighting purpose and other domestic purposes, which are in modern days considered as essential service. If the same electricity is used as input for manufacturing purpose making huge bill of lakhs of rupees to get output from that industry, then to our understanding, supply of electricity is used as input for manufacturing purpose to get output from the factory and it obviously to make profits. Essential service is a service for survival of human kind, but not for making*

⁷⁶ Bankruptcy Law Reform Committee, *Report of the Bankruptcy Law Reform Committee*, Vol 1 (2015)

⁷⁷ *ICICI Bank Ltd. v M/s. Innoventive Industries Ltd.*, MA 157 in CP 01/I&BP/2016. Decision date- 23.08.2017

business and earn profits without making payment to the services used. When company is using it for making profit, then the company owes to make payment to the services/goods utilized in manufacturing purpose.”

However, in the case of *Canara Bank v. Deccan Chronicle*,⁷⁸ supplies of critical input goods and services was also mandated. “Section 14(2) of the IBC, 2016 already exempted supply of essential goods and services to the Corporate Debtor and in addition the Learned Counsels for the Respondent submitted that goods/services viz., Water, Electricity, Printing Ink, Printing Plates, Printing Blanker, Solvents etc. will also come under the purview of exemption and thus prayed to exempt above goods/services from moratorium. We are convinced with the prayer of the Respondent that the above goods and services would come under exemption under this Section... and these essential goods or services to Corporate Debtor shall not be terminated or suspended and interrupted during the moratorium period”.

This created some ambiguity on the position of law. However, the NCLAT has specifically opined that “From sub-section (2) of Section 14 of the 'I&B Code', it is also clear that essential goods or services, including electricity, water, telecommunication services and information technology services, if they are not a direct input to the output produced or supplied by the 'Corporate Debtor', cannot be terminated or suspended or interrupted during the 'Moratorium' period.”⁷⁹

Given that the supplies of such essential goods and services is mandated by the Code, the amounts due to such suppliers is given priority since these have been designated as insolvency resolution process costs,⁸⁰ which are to be paid in priority to other debts of the corporate debtor.⁸¹ However, there was lack of clarity on whether payments need to be made for the supply of these goods and services during the moratorium period.

In *Innoventive Industries Ltd. v. Maharashtra State Electricity Distribution Company Ltd.*⁸², the NCLAT passed an order requiring “the (Interim) Resolution Professional (IRP) to pay the charges due to respondent towards consumption of electricity since the date of moratorium...the IRP on behalf of the 'Corporate Debtor' will also pay month to month charges towards consumption of electricity failing which it will be open to the respondent – Maharashtra State Electricity Distribution Company Limited to take appropriate steps.”

In *Dakshin Gujarat VIJ Company Limited v. ABG Shipyard Limited*,⁸³ the NCLAT explained its reasoning for requiring payments for supply of essential goods and services during the moratorium period. They opined that “from the provisions of 'I&B Code' and Regulations, we find that no prohibition has been made or bar imposed towards payment of current charges of essential services. Such payment is not covered by the order of 'Moratorium'. Regulation 31 cannot override the substantive provisions of Section 14; therefore, if any cost is incurred towards supply of the essential services during the period of 'Moratorium', it may be accounted towards 'Insolvency Resolution Process Costs', but law does not stipulate that the suppliers of essential goods including, the electricity or water to be supplied free of cost, till completion of the period of 'Moratorium'. Payment if made towards essential goods to ensure that the Company remains on-going as made in the present case for the month of December, 2017, such amount can be accounted towards 'Insolvency Resolution Process Costs', but it does not mean that supply of essential goods such as electricity to be supplied free of cost and the 'Corporate Debtor' is not liable to pay the amount till the completion of the period of 'Moratorium'.” The NCLAT also noted that “if the 'Corporate Debtor' has no fund even to pay for supply of essential goods and services, in such case, the 'Resolution Professional' cannot keep the Company on-going just to put additional cost towards supply of electricity, water etc. In case the 'Corporate Debtor' (Company) is non-functional due to paucity of fund, and has become sick the question of keeping it on going does not arise”.

While the NCLAT has allowed payments to be made to suppliers during the process, it has not passed orders specifically allowing suppliers of essential goods and services to recover dues remaining unpaid prior to the commencement of the insolvency resolution process while the moratorium was in place. Instead they have held

⁷⁸ *Canara Bank v. Deccan Chronicle Holdings Ltd.*, CP No. IB/41/7/HDB/2017. Decision date- 19.07.2017

⁷⁹ *Dakshin Gujarat VIJ Company Limited v. ABG Shipyard, Limited Company Appeal (AT) (Insolvency) No. 334 of 2017*. Decision date- 08.02.2018

⁸⁰ Regulation 31, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons), 2016

⁸¹ Section 30(2), Code

⁸² *Innoventive Industries Ltd. v. Maharashtra State Electricity Distribution Company Ltd.*, Company Appeal (AT) (Insolvency) No. 156 of 2017 & I.A. No. 612 of 2017. Decision date- 06.10.2017

⁸³ *Dakshin Gujarat VIJ Company Limited v. ABG Shipyard, Company Appeal (AT) (Insolvency) No. 334 of 2017*. Decision date- 8.02.2018

that it would be open for the supplier to submit a claim for payment of their dues before the resolution professional.⁸⁴

(b) Other critical supplies

In so far as critical supplies other than those defined as 'essential goods and services' are concerned,⁸⁵ the supplies are to be procured by mutual agreement between the insolvency professional and the supplier, sometimes with approval of the committee of creditors. This is facilitated by the provisions of the Code which enable the functioning of the debtor as a going concern. Specifically, the Code requires that the interim resolution professional and resolution professional make every endeavour to run the corporate debtor as a going concern, and take all actions as are necessary to keep the corporate debtor as a going concern.⁸⁶

Like 'essential goods and services', the payment for other critical supplies will form part of cost of the insolvency resolution process and such suppliers have priority over other creditors under the resolution plan.

However, despite this, some critical suppliers might be reluctant to supply during the insolvency resolution process. Recognizing this, the Insolvency Law Committee advocated for expanding the scope of mandatory essential supplies covered under section 14(2). To that end, the Committee recommended that a proviso to section 14(2) may be added "*which states that for continuation of supply of essential goods or services other than as specified by IBBI, the IRP/ RP shall make an application to the NCLT and the NCLT will make a decision in this respect based on the facts and circumstances of each case*".⁸⁷ However, this suggestion was not adopted as an amendment to the Code.

Conclusion

The Code enables the continuation of critical supplies to businesses during the insolvency resolution process. It enables the resolution professional to negotiate for the continuation of other critical supplies during the corporate resolution process and mandates the supply of the enumerated 'essential goods and services'. Payments for such supplies have priority of payment over other claims in the resolution plan. Further, the NCLAT has in many cases ordered that 'essential goods and services' be paid for *during* the insolvency resolution process.

⁸⁴Uttarakhand Power Corporation Ltd. v. ANG Industries Ltd., Company Appeal (AT) (Insolvency) No. 298 of 2017. Decision date- 24.01.2018; Innoventive Industries Ltd. v. Maharashtra State Electricity Distribution Company Ltd., Company Appeal (AT) (Insolvency) No. 156 of 2017 & I.A. No. 612 of 2017. Decision date- 06.10.2017

⁸⁵This does not apply to leaseholds, that are specifically covered under section 14(1)(d) of the Code.

⁸⁶Section 20, Code read with section 23(2), Code

⁸⁷Insolvency Law Committee, Report of the Insolvency Law Committee, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf

Provision for Mutual Settlement after the Admission of a Case under the Code

Introduction

Insolvency proceedings are mandatory and collective proceedings that are initiated to resolve the distress of a debtor. For creditors, the purpose of these proceedings is to enable recovery of their debts in a way that maximizes value for them. Given that the creditors act as a collective for maximizing value and not as individuals grabbing at the assets of the debtor for their own interest, formal insolvency processes bring with them a wide range of consequences for the whole company and all the stakeholders. Accordingly, creditors are usually not allowed to determine the status of the insolvency proceedings *individually*.

However, in some cases, even where the tests for initiating an insolvency resolution are met, the debtor may not be in distress. For instance, under the Code, even where default is proven by a creditor, it may be that the corporate debtor has sufficient funds to service this debt as it falls due and its assets are generally sufficient to cover the liabilities. The default may have occurred due to an extraneous reason and the debtor may be willing to remedy the default.

In such cases, a balance needs to be drawn between two competing objectives- ensuring that the collective rights of the stakeholders are not compromised and ensuring that a company does not have to undergo an insolvency resolution process where the pre-condition of insolvency itself is not satisfied.

Analysis

Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 provides that “*The Adjudicating Authority may permit withdrawal of the application made under rules 4, 6 or 7, as the case may be, on a request made by the applicant before its admission.*” This provision allows for the withdrawal of the application before it is admitted. However, there was originally no provision allowing for withdrawal due to mutual settlement once the insolvency resolution process was admitted. Consequently, there was a lack of clarity on the ability of an applicant to withdraw their application for initiation of the insolvency resolution process.

In *Parker Hannifin India Private Limited v. Prowess International Private Limited*,⁸⁸ the Kolkata bench of the NCLT held that once a petition is admitted, neither of the parties have the right to withdraw the petition. However, the Chennai Bench of the NCLT took an opposite view in *M/s. Phoenix Global DMCC v. M/s. A&A Trading International Pvt. Ltd.*⁸⁹ While exercising its inherent powers under Rule 11 of the National Company Law Tribunal Rules, 2016, the NCLT recalled its order for commencement of corporate insolvency resolution process and declaration of moratorium once the corporate debtor duly paid the outstanding amount and settled its dispute with the operational creditor. However, the order was recalled given the facts of this particular case where the insolvency resolution professional had not been appointed, no public announcement had been made, no other dues existed other than the dues in this case which had been paid.

The NCLAT in *Mother Pride Dairy India Pvt. Ltd. v. Portrait Advertising & Marketing Pvt. Ltd.*⁹⁰ took the view that once an application is admitted, it cannot be withdrawn since other creditors are entitled to raise claims. However, “*if the appellant satisfies the claim of other creditors, whoever has made claim, in that case Insolvency Resolution Professional will bring the matter to the notice of learned Adjudicating Authority for closure of the resolution*”

⁸⁸ *Parker Hannifin India Private Limited v. Prowess International Private Limited*, C.P. (IB) No. 150/KB/2017. Decision date- 17.10.2017.

⁸⁹ *M/s. Phoenix Global DMCC v. M/s. A&A Trading International Pvt. Ltd.*, CP/500/(IB)CB/2017. Decision date- 16.06.2017.

⁹⁰ *Mother Pride Dairy India Pvt. Ltd. v. Portrait Advertising & Marketing Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 94 of 2017. Decision date- 13.07.2017.

process. The learned Adjudicating Authority in such case will consider the case in accordance with law, even before completion of Resolution process and may close the matter.”

In *Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LLP*,⁹¹ the NCLAT held that “before admission of an application under Section 7, it is open to the Financial Creditor to withdraw the application but once it is admitted, it cannot be withdrawn...Even the Financial Creditor cannot be allowed to withdraw the application once admitted, and matter cannot be closed till claim of all the creditors are satisfied by the corporate debtor.” The NCLAT also rejected the submission of the appellant for invocation of inherent powers under Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 as the said Rule 11 of the NCLAT Rules has not been adopted for the purpose of the Code and only Rules 20 to 26 have been adopted in absence of any specific inherent power and where there is no merit, the question of exercising inherent power did not arise.

However, in *Agroh Infrastructure Developers Pvt. Ltd. v. Narmada Construction (Indore) Pvt. Ltd.*,⁹² the NCLAT held that given that no demand notice had been served to the corporate debtor, the NCLT did not serve notice upon corporate debtor before admitting the application which was against the principles of natural justice, the operational creditor could withdraw the application even after admission of the application if the parties had settled the matter amongst themselves.

The issue was settled by the Supreme Court in *Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LLP*.⁹³ In this case the court held that the NCLAT had been correct in deciding that the inherent power of the NCLAT and NCLT cannot be exercised to allow for withdrawal of an application after its admission. However, it exercised its powers under Article 142 of the Constitution of India to allow for withdrawal of the application by consent. Thereafter, in *Uttara Foods v. Mona Parachem*,⁹⁴ the Supreme Court recommended that the Rules be amended to allow for compromise and withdrawal.

The Insolvency Law Committee deliberated on this issue and stated that “on a review of the multiple NCLT and NCLAT judgments in this regard, the consistent pattern that emerged was that a settlement may be reached amongst all creditors and the debtor, for the purpose of a withdrawal to be granted, and not only the applicant creditor and the debtor. On this basis read with the intent of the Code, the Committee unanimously agreed that the relevant rules may be amended to provide for withdrawal post admission if the CoC approves of such action by a voting share of ninety per cent.”⁹⁵ This recommendation was then adopted as section 12A in the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, which allows post-admission withdrawal based on “an application made by the applicant with the approval of ninety per cent voting share of the committee of creditors.”

This recommendation was also relied on by the Supreme Court in *Swiss Ribbons Ltd. v. Union of India*,⁹⁶ while interpreting the constitutionality of section 12A. The Court held that once an application to trigger the corporate insolvency resolution process is admitted, the proceeding becomes a proceeding *in rem* and it becomes necessary to have the approval of the committee of creditors before any individual claim may be settled. However, the Court went on to clarify that where the committee of creditors has not been constituted yet, “a party can approach the NCLT directly, which Tribunal may, in exercise of its inherent powers under Rule 11 of the NCLT Rules, 2016, allow or disallow an application for withdrawal or settlement...This will be decided after hearing all the concerned parties and considering all relevant factors on the facts of each case.”

The Insolvency and Bankruptcy Board of India has also issued Regulation 30A to guide the process of making an application under section 12A. Among other things, the Regulation specifies “An application for withdrawal under

⁹¹ *Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LLP*, Company Appeal (AT) (Insolvency) No. 95 of 2017. Decision date- 13.07.2017.

⁹² *Agroh Infrastructure Developers Pvt. Ltd. v. Narmada Construction (Indore) Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 57 of 2017. Decision date- 02.06.2017.

⁹³ *Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LLP*, Civil Appeal No. 9279 of 2017. Decision date- 24.07.2017.

⁹⁴ *Uttara Foods and Feeds Pvt. Ltd. v. Mona Parachem*, Civil Appeal No. 18520 of 2017. Decision date- 13.11.2017.

⁹⁵ Insolvency Law Committee, Report of the Insolvency Law Committee, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf.

⁹⁶ *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India*, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019.

section 12A shall be submitted to the interim resolution professional or the resolution professional, as the case may be, in Form FA of the Schedule before issue of invitation for expression of interest under regulation 36A.” The applicability of this Regulation was examined in *Francis John Kattukaran v. The Federal Bank Ltd. & Anr.*⁹⁷ The Resolution Professional filed an application for withdrawal which was unanimously approved by the Committee of Creditors, but the NCLAT held that the application for withdrawal under Section 7, 9 or 10, can be filed only by the applicant and not by the Resolution Professional. The applicant argued that under Regulation 30A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, the Resolution Professional can also move the application for withdrawal. However, the Appellate Tribunal setting aside this contention held that “Regulation 30A cannot over-ride the substantive provisions of Section 12A according to which the ‘applicant’ can only move application for withdrawal of the application before the Adjudicating Authority and not by the ‘resolution professional’.” A similar view was taken in *Brilliant Alloys Pvt. Ltd. v. S. Rajagopal & Ors.*⁹⁸ Here the issue was whether the withdrawal agreed upon by the Corporate Debtor as well as Financial Creditor should be disallowed on the ground that the Regulation 30A stipulates that withdrawal cannot be allowed after the invitation for expression of interest has been issued. However, the Supreme Court held that the Regulation has to be read along with the main provision, that is, Section 12A, which does not provide for any such stipulation. The stipulation provided under the Regulation can therefore “only be construed as directory depending on the facts of each case”.

However, even where the requirements for approval under section 12A are met, the Adjudicating Authority may resist the withdrawal of the proceedings. In an order passed in *Andhra Bank v. Sterling Biotech*,⁹⁹ for instance, the NCLT stayed the application for withdrawal of proceedings on the grounds that the acceptance of the proposal for withdrawal appeared to have been made in suspicious circumstances. While this matter has not reached finality, it indicates that the Adjudicating Authority may look into the circumstances in which the withdrawal has been approved by the creditors.

Conclusion

Following the amendment to the Code, section 12A of the Code read with Regulation 30A provides the manner in which the insolvency resolution process can be withdrawn. Since the insolvency resolution process is a proceeding *in rem*, typically the approval of nearly the entire committee of creditors is required. However, where the committee of creditors is not in existence, an application may be made to the Adjudicating Authority for its directions. Even where the committee of creditors approves the withdrawal of the corporate insolvency resolution process, the Adjudicating Authority may intervene in the case of an illegality or abuse of process.

⁹⁷ *Francis John Kattukaran v. The Federal Bank Ltd. & Anr.*, Company Appeal (AT) (Insolvency) No. 242 of 2018. Decision date- 13.11.2018.

⁹⁸ *Brilliant Alloys Pvt. Ltd., v. S. Rajagopal & Ors.*, Petition(s) for Special Leave to Appeal (C) No(s). 31557/2018. Order date- 14.12.2018.

⁹⁹ *Andhra Bank v. Sterling Biotech Limited*, MA 951/2019 IN CP (IB)-490/MB/2018. Decision date- 11.03.2019.

Liability of Guarantors during the Corporate Insolvency Resolution Process

Introduction

The Code was enacted in the backdrop of increasing stress of non-performing assets on bank balance sheets. As corporate debtors have been brought into the insolvency resolution process, banks have invoked guarantees given to them on the debts due from these debtors.

Under contract law, a guarantor's liability is co-extensive with that of the principal debtor.¹⁰⁰ In other words, “a surety's liability to pay the debt is not removed by reason of the creditor's omission to sue the principal debtor. The creditor is not bound to exhaust his remedy against the principal before suing the surety, and a suit may be maintained against the surety though the principal has not been sued.”¹⁰¹ The liability of a principal debtor and the liability of a surety are separate and co-extensive liabilities. Notwithstanding the fact that they may stem from the same transaction, the two liabilities are distinct.¹⁰² Accordingly, it is possible to proceed against either the guarantor or the principal debtor in the first instance, or against both. If the claim is successful against the guarantor, the guarantor then steps into the shoes of the creditor and can proceed against the principal debtor, which is known as subrogation.

Given the distinctive nature of the proceedings under the Code, there is a need to examine if the same principles would apply to the processes therein.

Analysis

Section 60(2) of the Code provides that “where a corporate insolvency resolution process or liquidation proceeding of a corporate debtor is pending before a National Company Law Tribunal, an application relating to the insolvency resolution or liquidation or bankruptcy of a corporate guarantor or personal guarantor, as the case may be, of such corporate debtor shall be filed before the National Company Law Tribunal.” Given this, there is legislative clarity that concurrent insolvency proceedings can be maintained in respect of the corporate debtor and a guarantor.

However, there was a lack of clarity on whether proceedings could be initiated under debt recovery laws against a guarantor, while corporate insolvency resolution proceedings were underway against the corporate debtor.

In *Sanjeev Shriya v. State Bank of India*,¹⁰³ the Allahabad High Court assessed if proceedings of this nature can be instituted. In this case, the State Bank of India instituted proceedings against the personal guarantors of the corporate debtor and was participating in the insolvency resolution process of the corporate debtor. However, their liabilities had not crystallised. In this context, the court held that “the entire proceeding is still in fluid stage and for the same cause of action, two split proceedings cannot go simultaneously before the DRT as well as NCLT.”¹⁰⁴

The NCLAT in *State Bank of India v. Ramkrishnan*¹⁰⁵ and *State Bank of India v. Rajendra Kumar*¹⁰⁶ dealt with questions on maintenance of such proceedings in different fora. They held that the moratorium on institution of proceedings on recovery or recovery of debts under section 14 of the Code would cover the guarantor as well as

¹⁰⁰ *Ram Kishun and Ors. v. State of U.P. and Ors.* (2012)11 SCC 511. Decision date- 24.05.2012; *Central Bank of India and Ors. v. C.L. Vimla and Ors.* (2015) 7 SCC 337. Decision date- 28.04.2015

¹⁰¹ Pollock & Mulla, *Indian Contract and Specific Relief Act*, 728

¹⁰² *Hukumchand Insurance Co. Ltd. v. The Bank of Baroda & Others*, AIR 1977 Kant 204. Decision date- 05.04.1977

¹⁰³ *Sanjeev Shriya v. State Bank of India & Ors.*, W.P.(C) No. 30285 of 2017. Decision date- 6.09.2017

¹⁰⁴ *Ibid.*

¹⁰⁵ *State Bank of India v. V. Ramkrishnan*, Company Appeal (AT) (Insolvency) No. 213 of 2017. Decision date- 28.02.2018

¹⁰⁶ *State Bank of India v. D.S. Rajendra Kumar*, Company Appeal (AT) (Insolvency) Nos. 87, 88, 89, 90 and 91 of 2018. Decision date- 18.04.2018

the corporate debtor. However, this moratorium would “be applicable only to the proceedings against the ‘Corporate Debtor’ and the ‘Personal Guarantor’, if pending before any court of law/Tribunal or authority but the order of ‘Moratorium’ will not be applicable for filing application for triggering ‘Corporate Insolvency Resolution Process’ under Sections 7 or 9 or 10 of the Insolvency and Bankruptcy Code, 2016 against the ‘Guarantor’ or the ‘Personal Guarantor’ under Section 60(2).” In *Alpha & Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd.*¹⁰⁷ the NCLAT opined that “in so far as ‘guarantor’ is concerned, we are not expressing any opinion, as they come within the meaning of ‘Corporate Debtor individually’, as distinct from principal debtor who has taken a loan.”

The Bombay High Court took a divergent view in *Sicom Investments and Finance Limited v. Rajesh Kumar Drolia*¹⁰⁸ and held that “Section 14 is as clear as it can be. On reading Section 14, it is clear that the benefits as well as the liabilities mentioned therein are only that of the corporate debtor and corporate debtor alone. As far as prohibiting the institution of suits or continuation of pending suits or proceedings are concerned, the same applies only against the corporate debtor in insolvency and not a third party such as a guarantor, be it an individual or a corporate guarantor...What is absolutely clear from the Code is that for the guarantor (be it personal guarantor or corporate guarantor), there is no automatic protection. It is only once the insolvency resolution has been initiated either by or against the guarantor (be it personal guarantor or a corporate guarantor), only then the benefit of the moratorium would be available to the guarantor subject of-course to the other provisions of the IBC, 2016.”

The Insolvency Law Committee noted the decisions of the NCLAT and the Allahabad High Court and expressed its concern that these decisions put the surety’s liabilities on hold when the corporate debtor undergoes a corporate insolvency resolution process. The Committee opined that this “may lead to the contracts of guarantee being infructuous, and not serving the purpose for which they have been entered into” and cautioned that promoters who are often guarantors may cause the corporate debtor to file “frivolous applications to merely take advantage of the stay and guard their assets.” Given this, they advocated for the introduction of a clarificatory amendment to the Code, excluding guarantors from the scope of the moratorium under section 14 of the Code.¹⁰⁹ Consequently section 14 of the Code has been amended to disapply the moratorium to guarantors.

After this amendment was passed, its applicability was considered by the Supreme Court in an appeal to the NCLAT’s decision in *V. Ramakrishnan*.¹¹⁰ The Court held that since the amendment has been passed to clarify the issue, this amendment would have retrospective effect. Significantly, it also lent its support to the opinion of the Bombay High Court by holding it that it found that the reasoning in *Sicom* commends itself, whereas the reasoning in *Sanjeev Shriya* does not.

Another question that has been considered by courts is whether it is possible to proceed against a corporate guarantor under the Code without proceeding against the principal debtor. In *Ferro Alloys Corporation v. Rural Electrification Ltd.*,¹¹¹ the NCLAT observed that the Code does not prohibit the ‘Financial Creditor’ from initiating the corporate insolvency resolution process against the guarantor, since a guarantor is included in the definition of ‘Corporate Debtor’ as provided under Section 3(8) of the Code. Referring to various provisions and definitions provided under the Code, the Tribunal observed that “a guarantee becomes a debt or as soon as the guarantee is invoked against it whereinafter a guarantor (‘corporate guarantor’) becomes a ‘corporate debtor’ in terms of the I&B Code”. It further went on to observe that the Code “does not exclusively delineates and/or prescribes any inter-se rights, obligation and liabilities of a guarantor qua ‘financial creditor’. Thus, in absence of any express provision providing for inter-se rights, obligation and liabilities of guarantor qua ‘financial creditor’ under the Code, the same will have to be noticed from the provisions of the Indian Contract Act, which exclusively and elaborately deals with the same.” Thus, the Tribunal after referring to various Supreme Court judgements on the co-extensive liability of guarantor under the Indian Contract Act held, “it is not necessary to initiate ‘Corporate Insolvency Resolution Process’ against the

¹⁰⁷ *Alpha & Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd., Company Appeal (AT) (Insol.) No. 116 of 2016.* Decision date- 31.07.2017

¹⁰⁸ *Summons for Judgment No. 221 of 2010 in Commercial Suit No. 44 of 2010.* Decision date- 09.07.2018

¹⁰⁹ *Insolvency Law Committee, Report of the Insolvency Law Committee, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf*

¹¹⁰ *State Bank of India v. V. Ramakrishnan, Civil Appeal Nos. 3595 and 4553 of 2018.* Decision date- 14.08.2018

¹¹¹ *Ferro Alloys Corporation Ltd. & Ors. v. Rural Electrification Corporation Ltd., Company Appeal (AT) (Insolvency) No. 92,93 & 148 of 2017.* Decision date- 08.01.2019.

'Principal Borrower' before initiating 'Corporate Insolvency Resolution Process' against the 'Corporate Guarantors'. Without initiating any 'Corporate Insolvency Resolution Process' against the 'Principal Borrower', it is always open to the 'Financial Creditor' to initiate 'Corporate Insolvency Resolution Process' under Section 7 against the 'Corporate Guarantors', as the creditor is also the 'Financial Creditor' qua 'Corporate Guarantor'."

Given this, the NCLAT, in *Dr. Vishnu Kumar Agarwal v. Piramal Enterprise Ltd.*,¹¹² was called on to determine if the corporate insolvency resolution process can be initiated against the corporate guarantor even if the principal borrower is not a corporate person or corporate debtor. The NCLAT reiterated this reasoning and held that it is not necessary for the 'Financial Creditor' to initiate the corporate insolvency resolution process against the 'Principal Borrower' before initiating it against the 'Corporate Guarantor', since *"the creditor is also the 'Financial Creditor' qua 'Corporate Guarantor'"*. Thus, even if the 'Principal Borrower' is not a 'Corporate Person' and no application can be filed against it under Section 7, the 'Financial Creditor' has the freedom to file an application against the 'Corporate Guarantor' under Section 7.

In the same case, the NCLAT also considered if the corporate insolvency resolution process could be initiated against two corporate guarantors simultaneously, for the same debt and default. In this regard, the NCLAT held that *"there is no bar in the 'I&B Code' for filing simultaneously two applications under Section 7 against the 'Principal Borrower' as well as the 'Corporate Guarantor(s)' or against both the 'Guarantors'. However, once for same set of claim application under Section 7 filed by the 'Financial Creditor' is admitted against one of the 'Corporate Debtor' ('Principal Borrower' or 'Corporate Guarantor(s)'), second application by the same 'Financial Creditor' for same set of claim and default cannot be admitted against the other 'Corporate Debtor' (the 'Corporate Guarantor(s)' or the 'Principal Borrower')."*

A further issue that has arisen in respect of guarantors is their right of subrogation against the corporate debtor that has undergone the corporate insolvency resolution process. Guarantors have contended that since they have a right of subrogation against the debtor, resolution plans that do not provide for payments of guaranteed debts to them would be discriminatory. However, this contention was rejected by the NCLAT. Personal guarantors were shareholders or promoters and a plan that did not provide for payments on account of guarantees to them would not be discriminatory and the *"'I&B Code' seeks to protect creditors of the 'Corporate Debtor' by preventing promoters from rewarding themselves at the expense of creditors and undermining the insolvency processes."*¹¹³ The Supreme Court also declined to interfere with this judgement on appeal.¹¹⁴

Conclusion

The liability of guarantors is considered to be co-extensive with, as well as distinctive from the liability of the principal corporate debtor under the Code. Accordingly, both the principal corporate debtor and the guarantor can be proceeded against under the Code. The guarantor can also be proceeded against under different fora, when the corporate debtor is being proceeded against under the Code. In the alternate, the guarantor can be proceeded against under the Code, even when a corporate insolvency resolution process has not been initiated against the principal debtor, and even when the principal debtor is not a corporate person. However, two corporate guarantors cannot be proceeded against simultaneously.

¹¹² *Dr. Vishnu Kumar Agarwal v. Piramal Enterprise Ltd.*, Company Appeal (AT) 346 of 2018. Decision date- 08.01.2019

¹¹³ *Lalit Mishra & Ors. v. Sharon Bio Medicine Ltd.*, Company Appeal (AT) (Insolvency) No. 164 of 2018. Decision date- 19.12.2018

¹¹⁴ *Lalit Mishra & Ord. v. Sharon Bio Medicine Ltd.*, Civil Appeal No. 1603 of 2019. Decision date- 05.04.2019

Assignment of Debts of Related Parties under the Corporate Insolvency Resolution Process

Introduction

The Preamble to the Code specifically states that the Code has been enacted to maximise value in the interests of *all* the stakeholders, and not for some stakeholders at the expense of the others. Thus, the insolvency regime is designed to reduce the possibility of allowing some stakeholders to benefit at the expense of the others.

This design choice becomes especially relevant in respect of the related parties of the corporate debtor. If these related parties are given the power to control the decisions regarding its insolvency resolution, they may choose to do so in a manner that would unfairly benefit the corporate debtor. In other words, there is a concern that related party creditors would not be able to act independently. At the same time, classes of creditors must be excluded only to the extent that the exclusion would preserve the value of the assets, or distribute the value fairly. Else it may result in an unwarranted deprivation of rights of creditors and in a chilling effect on the distressed asset resolution. Accordingly, any restrictions must be tailored narrowly and must not be overbroad.

The Code excludes those financial creditors who are related parties of the corporate debtor from participating in the committee of creditors. However, where related parties assign their debts, the status of such assignments needs to be explored.

Analysis

The Proviso to section 21(2) of the Code excludes a financial creditor who is a 'related party' to the corporate debtor from having "*any right of representation, participation or voting in a meeting of the committee of creditors*". An exception to this rule exists in the event that a "*financial creditor, regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares, prior to the insolvency commencement date.*"¹¹⁵

Section 5(24) of the Code provides an extensive definition of a related party. For example, a related party is one who is a director or partner of the corporate debtor or a relative of its director or partner, is a key managerial personnel of the corporate debtor or a relative its key managerial personnel, a person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act, etc.

Although the Code prohibits related parties from taking an active part in the functioning of a committee of creditors, there is lack of clarity on the position of unrelated third parties to whom debts of related parties have been assigned. The Code is silent on the status of an assignee within a committee of creditors. Regulation 28 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 only stipulates that in the event of assignment of debt due to one creditor to any other person, during the insolvency resolution process "*both parties shall provide the interim resolution professional or the resolution professional, as the case may be, the terms of such assignment or transfer and the identity of the assignee or transferee.*"

This gap was brought to the spotlight in *Edelweiss Asset Reconstruction Company Limited v. Synergy Dooray Automotive Limited*.¹¹⁶ This case related to the assignment of debt from one financial creditor, which was a related party by virtue of it being a sister concern of *Synergy Dooray*, to a third-party, effectively providing it with a place within the committee of creditors. It was contested by *Edelweiss* that this assignment was carried out with

¹¹⁵Section 21(2), Code

¹¹⁶ *Edelweiss Asset Reconstruction Company Limited v. Synergy Dooray Automotive Limited*, C.A. No. 57 of 2017 in CP (IB) No. 01/HDB/2017. Decision date- 02.08.2017

the ulterior motive of reducing the voting rights of other creditors, by making the assignee eligible to take part in resolutions discussed in the committee of creditors. The Hyderabad Bench of the NCLT, while observing that the assignment of debt, in this case, could only be considered to be similar to tax planning, held that since there was no relationship between the financial creditor and its third-party assignee, within the meaning of the term “related party”, the assignee could participate in the committee of creditors.¹¹⁷

In the matter of *Fortune Pharma Private Limited*,¹¹⁸ two related party financial creditors after filing applications for the institution of a corporate insolvency resolution process but before its admission carried out similar assignments of their debts to an unrelated third party. In this case, one member of the NCLT held that “a disqualification as existed at the time of initiation of the corporate insolvency resolution process by virtue of being a related party cannot get washed away just because an assignment is made with the sole objective of reducing the voting power of the existing corporate creditors.” To determine this, the NCLT may consider if the transaction has been done ‘bona fide’ for a legitimate business interest. However, the other member of the NCLT, in a concurring order held that given that an assignment only transfers the rights of the assignor and the assignee would have no better rights than the rights of the assignor. If the assignee was given any further rights, it would disadvantage other creditors. Consequently, “if the ‘assignor’ is a related party then the assignee shall also be treated in the same status as ‘related party’ vis-à-vis to the impugned debt.”

This matter was laid to rest by the NCLAT, which accepted this reasoning and held that “undisputedly, the assignment is the transfer of one’s right to recover the debt of another person as a contractual right. Rights of an ‘assignee’ are no better than those of the ‘assignor’. It can be, therefore, held that ‘assignor’ assigns its debt in favour of the ‘assignee’ and ‘assignee’ steps in the shoes of the ‘assignor’. The ‘assignee’ thereby takes over the right as it actually did and also takes over all the disadvantages by virtue of such assignment...What cannot be achieved directly by Mr. Sudhakar Mulay, he did it indirectly assigning his debt in favour of the 1st appellant. Mr. Sudhakar Mulay being the ‘related party’, with the assignment of ‘debt’, the disadvantage also goes to the 1st appellant.”¹¹⁹

Conclusion

The assignment of related party debts results in the assignee having the same rights and disabilities as those of the related party assignor.

¹¹⁷ *Edelweiss Asset Reconstruction Company Limited v. Synergy Dooray Automotive Limited*, C.A. No. 57 of 2017 in CP (IB) No. 01/HDB/2017. Decision date- 02.08.2017

¹¹⁸ In the matter of *Fortune Pharma Private Limited*, M.A. 560 in C.P. No. 1148/IB&C/NCLT/MB/MAH/2017. Decision date- 13.11.2017

¹¹⁹ *Pankaj Yadav v. State Bank of India*, Company Appeal (AT) (Insolvency) No. 28 of 2018. Decision date- 07.08.2018

Treatment of Home Buyers in the Corporate Insolvency Resolution Process

Introduction

The primary goal of insolvency law is to maximize the value of the assets of a debtor in the interests of all stakeholders. Value-maximisation is often a function of time, as the value may tend to erode with lapse of time. To address this, the process of negotiation between various creditors and stakeholders has to be designed in a manner that reduces the time taken for insolvency resolution.

One design choice that is made to reduce time taken, is to reduce the number of stakeholders that are given control of the negotiating process in insolvency resolution. However, where some stakeholders are not given control in the insolvency resolution process, there is a concern that their pre-insolvency rights may be displaced by those stakeholders who have been given control. Such a concern becomes particularly potent where the stakeholders who have not been given control are vulnerable classes such as home buyers.

Accordingly, it is relevant to analyse how the position of homebuyers is dealt with under the Code.

Analysis

Section 5 of the Code defines the terms 'financial debt' and 'operational debt'. These cover different types of claims against the corporate debtor, however, there may be classes of other claimants who are neither financial nor operational creditors. Initially, when claims in respect of pre-payments made by home buyers were brought to fore, the NCLT held that homebuyers were neither financial creditors nor operational creditors.¹²⁰ However, in cases where home buyers were guaranteed assured returns, they were held to be financial creditors.¹²¹ Given that in most cases, home buyers were not considered either financial creditors or operational creditors, they could not initiate the corporate insolvency resolution process or participate in the committee of creditors.

Further, the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 initially only provided a procedure for filing of claims by operational and financial creditors. As such homebuyers faced procedural difficulties in filing of claims. Once the concerns regarding inclusion of homebuyers were brought to fore, the Insolvency and Bankruptcy Board of India amended the Regulations to allow "other creditors" to also file their claims with the insolvency resolution process.¹²² They were however not allowed to initiate the insolvency resolution process or vote as members of the committee of creditors. As such, broader concerns regarding safeguarding of interests of home buyers remained unaddressed.

In *Chitra Sharma v. Union of India*, the Supreme Court required that the interests of the homebuyers be safeguarded by the insolvency resolution professional and passed orders allowing representatives espousing the cause of homebuyers to participate in the meetings of the committee of creditors.¹²³ Similarly, the Supreme Court in *Bikram Chatterji v. Union of India*¹²⁴ passed orders regarding the construction of homes and also required undertakings to be furnished to protect the interests of homebuyers.

Given this background, the Insolvency Law Committee opined that "On a review of various financial terms of agreements between home buyers and builders and the manner of utilisation of the disbursements made by home buyers

¹²⁰ Col. Vinod Awasthy v. AMR Infrastructure Limited, C.P. No. (IB)10(PB)/2017. Decision date- 20.02.2017

¹²¹ Nikhil Mehta and Sons v. AMR Infrastructure Ltd., Company Appeal (AT) (Insolvency) No. 07 of 2017. Decision date- 21.07.2017; Anil Mahindroo&Anr v. Earth Organics Infrastructure, NCLAT New Delhi, Company Appeal (AT) (Insolvency) No. 74/2017. Decision date- 02.08.2017

¹²² Regulation 9A, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons), 2016

¹²³ Chitra Sharma v. Union of India, Writ Petition(s)(Civil) No(s).744/2017. Decision date- 09.08.2018

¹²⁴ Bikram Chatterji v. Union of India, Writ Petition(s)(Civil) No(s).940/2017, Order date- 21.02. 2018

to the builders, it is evident that the agreement is for disbursement of money by the home buyer for the delivery of a building to be constructed in the future. The disbursement of money is made in relation to a future asset, and the contracts usually span a period of 4-5 years or more...the amounts so raised are used as a means of financing the real estate project, and are thus in effect a tool for raising finance, and on failure of the project, money is repaid based on time value of money.”¹²⁵ Accordingly, they recommended that home buyers should be included as financial creditors. Based on these recommendations, The Insolvency and Bankruptcy Code, (Second Amendment) Act, 2018 amended the definition of financial debt to reflect that an amount raised from an “allottee” under a real estate project would be deemed to be an amount having the commercial effect of a borrowing, squarely bringing homebuyers within the statutory purview of the term “financial creditor” under the Code.¹²⁶ Thus, homebuyers are now voting members of the committee of creditors.

Following this, the NCLAT has observed, “normally, an ‘allottee’ of Real Estate comes within the meaning of ‘Financial Creditor’ but if such an ‘allottee’ does not pay the full amount, cannot allege default on the part of the ‘Corporate Debtor’. If the ‘Corporate Debtor’ does not complete the work within time and the ‘allottee’ is agreed to pay the total amount or has paid the total amount then only the ‘allottee’ can allege default. Similarly, if ‘allottee’ finds that completion has not been made by the ‘Corporate Debtor’ within time and if request to return the amount disbursed to the ‘Corporate Debtor’, on failure to refund the amount the allottee can claim the default on the part of the ‘Corporate Debtor’.”¹²⁷

However, it is significant to note that merely being a homebuyer would not automatically bring the homebuyer within the purview of the term ‘financial creditor’. There has to be an actual debt that is owed to such homebuyer, payable by the infrastructure/ builder company for the purposes of the Code. In the matter of *Ajay Walia v. M/s. Sunworld Residency Private Limited*,¹²⁸ the homebuyer had entered into an apartment purchase agreement with the builder, as well as a supplementary agreement, which gave the homebuyer an option to cancel the purchase of the apartment within twenty four months from the date of disbursement of the home loan by the bank. The homebuyer, the bank and the builder also entered into a tripartite agreement by virtue of which the builder was supposed to pay the EMIs to the bank for the first twenty three months from the date of disbursement of such loans. However, such payment was not to be construed as reducing the liability of the homebuyer in any manner. The tripartite agreement further provided that in the event of occurrence of default under the agreement, which would result in the cancellation of allotment as a consequence, and/or for any reason whatsoever if the allotment is cancelled, any amount payable to the borrower in the event would be paid to the bank instead, and would be construed as a valid discharge of the builder’s liabilities towards the homebuyer. When the homebuyer had cancelled the booking, and later on, the builder defaulted in payment of EMIs, the homebuyer approached the NCLT for initiating the corporate insolvency resolution process against the builder company. Here, the NCLT observed that since the homebuyer had subrogated all its rights in favour of the bank, he could not be treated as financial creditor.

Conclusion

Given that home buyers were not given rights to initiate the insolvency resolution process or participate in the process as members of the committee of creditors, there was a concern that their interests would not be adequately safeguarded. Accordingly, *ad hoc* safeguards were imposed by the courts in different rulings. To settle this issue, home buyers have now been deemed to be financial creditors by amendment to the Code, and are members of the committee of creditors.

¹²⁵ Insolvency Law Committee, Report of the Insolvency Law Committee, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf

¹²⁶ Insolvency and Bankruptcy Code (Second Amendment Act), 2018 available at [http://ibbi.gov.in/webadmin/pdf/legalframework/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20\(Second%20Amendment\)%20Act,%202018_2018-08-18%2018:40:34.pdf](http://ibbi.gov.in/webadmin/pdf/legalframework/2018/Aug/The%20Insolvency%20and%20Bankruptcy%20Code%20(Second%20Amendment)%20Act,%202018_2018-08-18%2018:40:34.pdf)

¹²⁷ Anil Kumar Tulsiani v. Rakesh Kumar Gupta, Company Appeal (AT) (Insolvency) No. 35 of 2019. Decision date- 22.01.2019

¹²⁸ *Ajay Walia v. M/s Sunworld Residency Private Limited*, CP (IB) 11/ALD/2018. Decision date- 30.07.2018

Treatment of Statutory Dues under the Code

Introduction

A formal insolvency process should clearly delineate the status of different stakeholders in the process, to enable certainty and the orderly conduct of proceedings. The status of different stakeholders is ascertained with reference to their pre-insolvency entitlements and the achievement of policy objectives of the insolvency legislation.

An important set of stakeholders in the insolvency of an entity is governmental authorities, such as tax authorities, and regulators with whom the entity interacts on an ongoing basis. Given this, it is relevant to explore the status of the statutory dues both under the corporate insolvency resolution process and the liquidation process under the Code.

Analysis

In the corporate insolvency resolution process

In respect of the corporate insolvency resolution process, section 5(21) of the Code defines the term operational debt as “a claim in respect of the provision of goods or services including employment or a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.” While the definition of operational debt includes dues arising and payable to government, there was a lack of clarity on whether this would include statutory dues.

In this regard, the Calcutta High Court in *Akshay Jhunjhunwala v. Union of India*, held that the term operational debt “would also include a claim of a statutory authority on account of money receivable pursuant to an imposition by a statute.”¹²⁹ This position was reiterated by the NCLAT in *DG of Income Tax v. Synergies Dooray Automotive Ltd.*¹³⁰ wherein the bench opined that “If the Company (‘Corporate Debtor’) is operational and remains a going concern, only in such case, 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 Company is operational, we hold such statutory dues has direct nexus with operation of the Company. For the said reason also, we hold that all statutory dues including ‘Income Tax’, ‘Value Added Tax’ etc. come within the meaning of ‘Operational Debt’.”¹³¹

A related issue also arose during the deliberations of the Insolvency Law Committee which considered whether regulatory dues should be included in the definition of operational creditors. Keeping in mind the wide powers of Regulators to recover dues and penalties owed to them, the Committee observed that “regulatory dues were intentionally not included in the definition of operational debt. It was discussed that if any claim or obligation arises pursuant to non-payment by a corporate debtor in lieu of any goods or services provided by a regulatory body, it may be interpreted as ‘operational debt’ on a case to case basis.”¹³² Consequently, they recommended that the term ‘regulatory dues’ need not be added to the definition of operational debt.

Despite this, since statutory and regulatory dues are also backed by law, this issue may need further clarity from the Supreme Court for this position to become less contested in practice.

¹²⁹ *SreeMetaliks Ltd. v. Union of India*, Writ Petition 7144 (W) of 2017. Decision date- 07.04.2017.

¹³⁰ *DG of Income Tax v. Synergies Dooray Automotive Ltd.*, Company Appeal (AT) (Insolvency) No. 205 of 2017. Decision date- 20.03.2019

¹³¹ *Ibid.*

¹³² Insolvency Law Committee, Report of the Insolvency Law Committee, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf

In Liquidation

Section 53 of the Code provides a statutory 'waterfall' for distributions to be made after realization of assets of the corporate debtor. In this regard, "any amount due to the Central Government and State Government, including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date" has been listed as item (e) of section 53(1) after process costs, dues to workmen and employees, etc. Essentially, crown debt has now been subordinated to unsecured financial creditors among others. This is a significant change in comparison to the previous regime, in which Government dues were given preferential status over all payments other than those owed to workmen and secured creditors.¹³³ This change in policy was recommended by the Bankruptcy Law Reforms Committee which recognized that "the dues payable to the Crown are unlikely to be significant when compared to total government receipts, whereas the impact of non-payment on private commercial creditors is likely to be substantial and may even lead to their insolvency."¹³⁴ This was recommended with the objective that subordinating Government dues in this manner will "increase the availability of finance, reduce the cost of capital, promote entrepreneurship payment and lead to faster economic growth. The government also will be the beneficiary of this process as economic growth will increase revenues. Further, efficiency enhancement and consequent greater value capture through the proposed insolvency regime will bring in additional gains to both the economy and the exchequer."¹³⁵

While analyzing the position of the Income Tax department vis-à-vis a company in liquidation whose properties had been attached under the Income Tax Act, 1961, the Telangana and Andhra Pradesh High Court held that passing an order of attachment does not create property rights in the attached property. Consequently, "In the context of liquidation of an assessee company under the provisions of the Code, the Income-tax Department, not being a secured creditor, must necessarily take recourse to distribution of the liquidation assets as per Section 53 of the Code. Section 53(1) provides the order of priority for such distribution and any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State in respect of the whole or any part of the period of two years preceding the liquidation commencement date comes fifth in the order of priority under Clause (e) thereof... It is therefore clear that tax dues, being an input to the Consolidated Fund of India and of the States, clearly come within the ambit of Section 53(1)(e) of the Code. If the Legislature, in its wisdom, assigned the fifth position in the order of priority to such dues, it is not for this Court to delve into or belittle the rationale underlying the same."¹³⁶ Therefore, even where statutory authorities pass orders for the attachment of properties, the dues to them would not constitute secured debts, and would fall within the scope of section 53(1)(e).

Conclusion

Statutory dues are dues owed to the Government. These dues are operational debts, and the statutory creditors would be operational creditors. In liquidation, these dues would fall within section 53(1)(e), and distributions to be made to them would rank equal to debts owed to a secured creditor for any amount unpaid following the enforcement of security interest.

¹³³ Sections 326 and 327, Companies Act, 2013

¹³⁴ Bankruptcy Law Reforms Committee, The Interim Report of the Bankruptcy Law Reforms Committee, Page 96 (2015)

¹³⁵ Bankruptcy Law Reform Committee, Report of the Bankruptcy Law Reform Committee, Para 2, Vol 1 (2015)

¹³⁶ Leo Edibles and Fats Ltd. v. the Tax Recovery Officer, Writ Petition No. 8560-2018. Decision date- 26.07.2018

Dissenting Financial Creditors under the Code

Introduction

The ability to bind all creditors to a resolution plan sanctioned by a court or tribunal becomes key to the success of a resolution plan, or it would be near impossible to resolve the insolvency of a company that has a viable business for fear of 'holdouts'. This fear of 'holdouts' would also make resolution very costly since holdout creditors would have to be offered sweeteners for their assent. In the Indian context where non-performing assets on bank balance sheets are rising, there is an even greater need for the law to enable faster and cheaper resolution of insolvency. Consequently, the Code, by statutory enactment, binds all stakeholders to the majority decision.

That said, when creditors' rights to be paid are being displaced by a majority, it is important to ensure that there are some safeguards. If not, one risks a resolution plan that would be unfairly in favour of the assenting financial creditors, who would safeguard their own interests at the expense of these creditors. Accordingly, a balance ought to be struck.

Analysis

Under Section 30(4) of the Code, a resolution plan needs approval of sixty-six percent of the voting share of the financial creditors, in order to be approved by the Adjudicating Authority. The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 originally defined "*dissenting financial creditors*" as financial creditors who have voted against the resolution plan approved by the committee of creditors. However, there was a lack of clarity as to the actual scope of this term.

In *K. Sashidhar v. Kamineni Steel and Power India Pvt. Ltd. and Ors.*,¹³⁷ the Hyderabad bench of the NCLT had to consider a resolution plan that had received the consent of 66.67% in value of the financial creditors, and out of the remaining financial creditors, while 26.97% had dissented, 6.36% remained open. The NCLT observed that section 30(4) did not clarify whether such percentage is out of the total voting share of the financial creditors or those present during meetings of respective committee of creditors of financial creditors.

Thereafter, the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 were amended to indicate that "*financial creditors who...abstained from voting for the resolution plan*" would be considered dissenting financial creditors as well. Vide its circular dated 14th September, 2018, the Insolvency and Bankruptcy Board of India clarified that financial creditors who are not members of the Committee of Creditors, do not have any voting rights and thus, they cannot be considered either dissenting or abstaining creditors when it comes to approving a resolution process.¹³⁸

An argument was made against this interpretation on appeal in *K Sashidhar v. Indian Overseas Bank and Ors.*¹³⁹ before the Supreme Court. Here, the Court held that while calculating the required per cent age of votes of the financial creditors, "*the provisions as couched in the I&B Code do not permit computation of the voting share percentage by excluding the votes of financial creditors who had abstained.*" The Court also clarified that the percentage of voting share should be considered while calculating the approving votes for the purpose of meeting the voting thresholds, and that this would not be "*on the basis of members present and voting as such.*"

¹³⁷ *K. Sashidhar v. Kamineni Steel and Power India Pvt. Ltd. and Ors.*, CP(IB)No. 11/10/HDB/2017. Decision date- 27.11.2017

¹³⁸ Insolvency and Bankruptcy Board of India, *Voting in the Committee of Creditors*, http://ibbi.gov.in/webadmin/pdf/legalframework/2018/Sep/Circular-Voting%20in%20the%20Committee%20of%20Creditors_2018-09-14%2018:32:15.pdf

¹³⁹ *K. Sashidhar v. Indian Overseas Bank*, Civil Appeal No. 10673 of 2018. Decision date- 05.02.2019

The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 originally provided that the resolution plan must require that dissenting financial creditors are paid the liquidation value in priority to all other financial creditors who voted in favour of the resolution plan.¹⁴⁰

The question of providing prior payments to dissenting financial creditors was discussed by the Insolvency Law Committee¹⁴¹ since concerns were raised that this could be abused by creditors to get priority payments. The Committee concluded *“that dissenting financial creditors are placed in a disadvantageous position vis-à-vis the operational creditors, as the latter are given priority in payment not only ahead of other financial creditors but also in terms of time i.e. within thirty days from approval of the plan. Thus, the right to be paid prior to assenting financial creditors may not be diluted.”*

However, the NCLAT in *Central Bank of India v. Resolution Professional of the Sirpur Paper Mills Ltd. and Ors.*¹⁴² held that Regulation 38(1) providing for these mandatory payments were inconsistent with the Code. They held that *“the legislators having not made any discrimination between the same set of group such as ‘Financial Creditor’ or ‘Operational Creditor’, Board by its Regulation cannot mandate that the Resolution Plan should provide liquidation value to the ‘Operational Creditors’...Such regulation being against Section 240(1) cannot be taken into consideration and any Resolution Plan which provides liquidation value to the ‘Operational Creditor(s)’ or liquidation value to the dissenting ‘Financial Creditor(s)’ in view of clause (b) and (c) of Regulation 38(1), without any other reason to discriminate between two set of creditors similarly situated such as ‘Financial Creditors’ or the ‘Operational Creditors’ cannot be approved being illegal.”*

Following this decision, the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 were amended to remove this requirement of payment of liquidation value to dissenting financial creditors before paying to assenting financial creditors, as well as the definition of dissenting financial creditors.

Conclusion

Following a series of amendments to the Regulations and the Code, the scope of the term ‘dissenting financial creditor’ had become clear to include both creditors who had abstained and those who had voted to reject the resolution plan. While this definition has now been removed, the understanding will still aid in determining how the sixty-six per cent of voting shares of the committee of creditors is to be calculated.

¹⁴⁰ Regulation 38(1)(c), Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016

¹⁴¹ Insolvency Law Committee, Report of the Insolvency Law Committee, available at http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf

¹⁴² *Central Bank of India v. Resolution Professional of the Sirpur Paper Mills Ltd. and Ors.*, Company Appeal (AT) (Insolvency) No. 526 of 2018. Decision date- 12.09.2018

Applicability of section 29A of the Code

Introduction

One of the aims of an insolvency law is to preserve the standard of commercial morality. Typically, insolvency laws try to prevent and penalize misfeasance that causes misbehaviour in the run up to insolvency that could amount to abuse of limited liability. While preserving commercial morality, however, the measures implemented should not result in a chilling effect on business and on resolution of insolvency. Accordingly, a balance must be reached in the way measures are implemented.

The Code attempts to preserve commercial morality by incorporating provisions for avoidance of certain transactions, and penalising director misconduct. In addition, the Code specifically precludes specified classes of persons from participating in the resolution process by virtue of section 29A. It is relevant to analyse how the balance between preserving commercial morality and preventing a chilling effect on insolvency resolution is reached with regard to Section 29A of the Code.

Analysis

Under section 29A of the Code, a person “or any other person acting jointly or in concert with such person” will be ineligible to take up the role of a resolution applicant if he or she falls under any of the heads of ineligibility. For example, if such a person is an undischarged insolvent, is a wilful defaulter in accordance with the guidelines of the RBI issued under the Banking Regulation Act, 1949, is disqualified to act as a director under the Companies Act, 2013, is barred from trading in securities or accessing securities markets by SEBI, etc. then as per Section 29A, a bar operates against such person or any other person acting jointly or in concert with him or her in becoming a resolution applicant. Should such a person have a “connected person” who attracts any of the disqualifications, then, by virtue of such a connection, this person also attracts disqualification.¹⁴³ However, following the recommendations of the Insolvency Law Committee, MSMEs have been excluded from the operation of clauses (c) and (h) of section 29A.¹⁴⁴

Section 29A was enacted since concerns were raised that “persons who, with their misconduct contributed to defaults of companies or are otherwise undesirable, may misuse this situation due to lack of prohibition or restrictions to participate in the resolution or liquidation process, and gain or regain control of the corporate debtor. This may undermine the processes laid down in the Code as the unscrupulous person would be seen to be rewarded at the expense of creditors. In addition, in order to check that the undesirable persons who may have submitted their resolution plans in the absence of such a provision, responsibility is also being entrusted on the committee of creditors to give a reasonable period to repay overdue amounts and become eligible.”¹⁴⁵ The Supreme Court in *Chitra Sharma v. Union of India*,¹⁴⁶ while dealing with the question of eligibility of a resolution applicant, held *inter alia* that the primary purpose behind Section 29A was to ensure that the persons responsible for insolvency of the corporate debtor do not participate in the corporate insolvency resolution process by means of a backdoor entry, effectuate public interest and ensure effective corporate governance. Therefore, the Section must be applied in a manner that effectuates and furthers this purpose.

Despite the public purpose of this amendment, there was a concern that section 29A could hinder the resolution of corporate debtors if not applied correctly. Accordingly, clarifications were sought about the time at which the operation of this section would become applicable.

¹⁴³ Explanation 6 to Clause (j) of Section 29A, Code defines a “connected person” as “(i) any person who is the promoter or in the management or control of the resolution applicant; or (ii) any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or (iii) the holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii)....”

¹⁴⁴ Section 240A, Code, inserted by the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018

¹⁴⁵ Statement of Objects and Reasons, Insolvency and Bankruptcy Code (Amendment) Bill, 2017

¹⁴⁶ *Chitra Sharma v. Union of India*, Writ Petition(s)(Civil) No(s).744/2017. Decision date- 09.08.2018

Section 30(4) of the Code states that the “committee of creditors shall not approve a resolution plan, submitted before the commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 (Ord. 7 of 2017), where the resolution applicant is ineligible under section 29A and may require the resolution professional to invite a fresh resolution plan where no other resolution plan is available with it.” However, the Mumbai Bench of the NCLT in *Wig Associates Pvt. Ltd.*,¹⁴⁷ determined that since as a general principle of statutory interpretation, an amendment which affects the legal rights of a person should necessarily be prospective in nature, unless expressly or by necessary implication deemed retrospective by the legislation, the application of the Amendment which added Section 29A was prospective in nature, from the date it came into force as an Ordinance, i.e. on 23 November 2017. It was held that it will not apply to initiated or pending insolvency proceedings, which by their very nature are continuous and cannot be halted or altered.

Even where cases have commenced post the enactment of this section, there was a lack of clarity as to the exact time when the eligibility of a resolution applicant vis-a-vis section 29A should be evaluated. In *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta*,¹⁴⁸ the Supreme Court made it clear that a resolution professional must only “examine” and “confirm” that a resolution plan conforms to the parameters of Section 30(2) before presenting the plan to the committee of creditors under Section 25(2)(i) read with Section 30(3). The Supreme Court noted that a resolution professional is only required to conduct due diligence, examine each resolution plan and determine as to whether or not it is complete in all respects before placing it before each committee of creditors. It held that in the event a resolution professional forms an opinion that a resolution plan contravenes any provisions of the law, including Section 29A of the Code, he or she is only expected to present an opinion before the committee of creditors and not render a decision regarding the validity of a resolution plan.

The Supreme Court also dealt with the interpretation of Section 29A(c) wherein it was observed that “person who wishes to submit a resolution plan acting jointly or in concert with other persons, any of whom may either manage, control or be a promoter of a corporate debtor classified as a non-performing asset in the period abovementioned, first pay off the debt of the said corporate debtor classified as a non-performing asset in order to become eligible under Section 29A(c).”

The Supreme Court made it clear that ineligibility of an applicant must be determined at the time of submission of a resolution plan. This was because, while each committee of creditors is vested with the duty of either approving or disapproving a resolution plan, in light of section 29A and as per the parameters of Section 30 of the Code, this is not final. It is the Adjudicating Authority; a quasi-judicial body under Section 31, which determines if a plan is in consonance with Section 30, and its requirements (including that of Section 29A). Both in cases where approval is granted and when a plan is rejected, Section 61 provides another avenue for appeal.¹⁴⁹

In *Swiss Ribbons v. Union of India*,¹⁵⁰ various challenges were raised against the validity of section 29A. The validity of this section was challenged on the grounds, that first, the retrospective application of section 29A prejudices the vested rights of erstwhile promoters to participate in the resolution process, as well as the liquidation process. The Court held that “a statute is not retrospective merely because it affects existing rights; nor is it retrospective merely because a part of the requisites for its action is drawn from a time antecedent to its passing”. Further, relying on its decision in *ArcelorMittal*, the Court held that since there is no vested right of the resolution applicant for approval or consideration of the resolution, “no vested right is taken away by application of Section 29A.” In addition to this, with respect to challenge to proviso Section 35(1)(f), the Court held that “the same rationale that has been provided earlier in this judgment will apply to this proviso as well – there is no vested right in an erstwhile promoter of a corporate debtor to bid for the immovable and movable property of the corporate debtor in liquidation. Further, given the categories of persons who are ineligible under Section 29A, which includes persons who are malfeasant, or persons who have fallen foul of the law in some way, and persons who are unable to pay their debts in

¹⁴⁷ In the matter of *Wig Associates Pvt. Ltd.*, M.A. No. 435 of 2018 in C.P. No. 1214/I&BC/NCLT/MB/MAH/2017. Decision date- 04.06.2018

¹⁴⁸ *ArcelorMittal India Pvt. Ltd. v. Satish Kumar Gupta & Ors.*, C.A. Nos. 9402-9405 of 2017. Decision date- 04.10.2018

¹⁴⁹ In this case, while both the resolution applicants were ineligible, taking note of the plea made by the committee of creditor’s that it did not wish for a liquidation, the Supreme Court exercised its powers under Article 142 of the Constitution of India and allowed for each applicant to make to remove their ineligibility under Section 29A(c) and make fresh bids for the corporate debtor.

¹⁵⁰ *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India*, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019.

the grace period allowed, are further, by this proviso, interdicted from purchasing assets of the corporate debtor whose debts they have either wilfully not paid or have been unable to pay. The legislative purpose which permeates Section 29A continues to permeate the Section when it applies not merely to resolution applicants, but to liquidation also. Consequently, this plea is also rejected". In addition, it was argued that section 29A(c) treats unequals as equals by treating promoters who did not act with malfeasance on par with those who had. The Court held that section 29A was intended to apply to persons other than criminals or those who had displayed malfeasance, and this was justified by the legislative purpose of the section.

It was also argued that the period of one year prescribed in section 29A for the disqualification to apply was arbitrary and without basis. While referring to the RBI's *Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances* dated 01.07.2015, the Court observed that a person's accounts are classified as NPA only when the debt remain overdue for more than 90 days. After that, one year of grace period is granted to the defaulter to pay off this debt and if the defaulter is still unable to pay off the debt in this period, the person becomes ineligible to become a resolution applicant. The Court opined that *"the legislative policy, therefore, is that a person who is unable to service its own debt beyond the grace period referred to above, is unfit to be eligible to become a resolution applicant. This policy cannot be found fault with. Neither can the period of one year be found fault with, as this is a policy matter decided by the RBI and which emerges from its Master Circular, as during this period, an NPA is classified as a substandard asset."*¹⁵¹

The petitioners also argued that a person, who is otherwise qualified to be a resolution applicant, cannot be held to be ineligible to become a resolution applicant merely on the ground that he is a relative of an ineligible person. The Court held that *"we are of the view that persons who act jointly or in concert with others are connected with the business activity of the resolution applicant. Similarly, all the categories of persons mentioned in Section 5(24A) show that such persons must be "connected" with the resolution applicant within the meaning of Section 29A(j). This being the case, the said categories of persons who are collectively mentioned under the caption "relative" obviously need to have a connection with the business activity of the resolution applicant."* Thus, the applicability of section 29A to related parties was restricted.

Finally, it was argued that the exemption of MSMEs from section 29A was arbitrary. The Court held that it was not arbitrary since *"the rationale for excluding such industries from the eligibility criteria laid down in Section 29A(c) and 29A(h) is because qua such industries, other resolution applicants may not be forthcoming, which then will inevitably lead not to resolution, but to liquidation."*¹⁵²

Conclusion

The validity of section 29A has been upheld by the Supreme Court in *Swiss Ribbons v. Union of India*. Significantly, it has been held that section 29A is based on a justifiable legislative policy choice that a person who is unable to service its own debt is unfit to be a resolution applicant. Moreover, the Supreme Court has clarified that section 29A would only be applicable to those related parties of persons ineligible under section 29A who are connected to the business activity of the ineligible person. The Supreme Court in *ArcelorMittal India* has clarified that it is clear that in order to establish the eligibility of a resolution applicant in the matter of submission of a resolution plan, the same must be determined at the very moment of the submission of a plan and in accordance with the relevant parameters of Section 29A of the Code applicable at the time.

¹⁵¹ *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019.*

¹⁵² *Ibid.*

Distributions under a Resolution Plan

Introduction

Insolvency is premised on insufficiency of funds. When a company is insolvent, it is likely that all stakeholders may not be able to receive the amounts due to them from the company in full. In this scenario, an insolvency regime provides a system of priorities in consonance with which distribution is made to creditors. This system of priorities interacts with the pre-insolvency entitlements of the stakeholders of a corporate debtor. To the extent insolvency law respects the pre-insolvency entitlements of parties, it enables parties to be able to structure their transactions so as to receive priority in insolvency, which is likely to lower costs of finance, and it creates the right incentives for parties to trigger insolvency processes, instead of promoting or discouraging the use of the processes based on a relative improvement or deterioration of entitlement in insolvency.¹⁵³ On the other hand, where pre-insolvency entitlements are respected indiscriminately, they may be abused to the detriment of non-adjusting creditors.¹⁵⁴ While the Code provides a clear system of priorities in liquidation,¹⁵⁵ it is relevant to ascertain the system of priorities under the corporate insolvency resolution process of the Code.

Analysis

Section 30(2) of the Code provides the minimum contents of a resolution plan. A resolution plan must provide for “the payment of insolvency resolution process costs in a manner specified by the Board in priority to the payment of other debts of the corporate debtor” and the payment of the minimum liquidation value due to operational creditors. Regulation 38 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2018 also provides that the “amount due to the operational creditors under a resolution plan shall be given priority in payment over financial creditors” and that a resolution plan “shall include a statement as to how it has dealt with the interests of all stakeholders, including financial creditors and operational creditors, of the corporate debtor”.¹⁵⁶

Originally, the Regulations also provided for the payment of liquidation value to dissenting financial creditors. However, based on the observations of the NCLAT in *Central Bank of India v. RP of Sirpur Paper Mills Ltd.* that “The right to dissent has been provided under sub-section (4) of Section 30 of the Insolvency and Bankruptcy Code, 2016 (for short ‘I&B Code’); a creditor who has dissented cannot be unsuited on the ground that he has dissented and eligible only for liquidation value. The question of grant of liquidation value to any of the Creditor does not arise cannot be applied at the stage of ‘Corporate Insolvency Resolution Process’ while submitting the Resolution Plan, as Section 53 is applicable only at the stage of Liquidation”¹⁵⁷ and that Insolvency and Bankruptcy Board of India would not have the power to require the payment of liquidation value to dissenting creditors, the Regulations were amended to delete this requirement.

Therefore, the provisions of the law do not explicitly provide a detailed list of priority of payments in the resolution plan, and it has been concluded that the priorities under section 53 would not apply to a resolution plan.¹⁵⁸ However, these priorities may be relied on to calculate the liquidation value, which must be paid at a minimum to the operational creditors.

¹⁵³ See: Jackson, *The Logic and Limits of Bankruptcy Law*, (2002)

¹⁵⁴ Oditah, *Assets and Treatment of Claims in Insolvency*, (1992) 108 *Law Quarterly Review* 459

¹⁵⁵ Section 53, Code

¹⁵⁶ Regulation 38(1) and 38(1A), Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons), 2016

¹⁵⁷ *Central Bank of India v. RP of Sirpur Paper Mills Ltd.*, Company Appeal (AT) (Insolvency) No. 526 of 2018. Decision date- 12.09.2018

¹⁵⁸ *Binani Industries Ltd. &Anr. v. Bank of Baroda &Anr.*, Company Appeals (AT) (Insolvency) No. 82, 123, 188 of 2018. Decision date- 14.11.2018

Consequently, priority is determined on a case-by-case basis as per the terms of the resolution plan that is approved by the committee of creditors. However, the committee of creditors do not have unfettered discretion to approve any resolution plan. The NCLAT in *Rajputana Properties v. Ultratech Cement Ltd.* has held that

- i. *The liabilities of all creditors who are not part of 'Committee of Creditors' must also be met in the resolution.*
- ii. *The 'Financial Creditors can modify the terms of existing liabilities, while other creditors cannot take risk of postponing payment for better future prospectus. That is, 'Financial Creditors' can take haircut and can take their dues in future, while 'Operational Creditors' need to be paid immediately.*
- iii. *A creditor cannot maximise his own interests in view of moratorium.'*
- iv. *If one type of credit is given preferential treatment, the other type of credit will disappear from market. This will be against the objective of promoting availability of credit.*
- v. *The 'I&B Code' aims to balance the interests of all stakeholders and does not maximise value for 'Financial Creditors'.*
- vi. *Therefore, the dues of creditors of 'Operational Creditors' must get at least similar treatment as compared to the due of 'Financial Creditors'.*¹⁵⁹

Further, the NCLAT has also held that the treatment of similarly situated financial creditors cannot be different.¹⁶⁰ These principles encapsulate the principle of 'fair and equitable' dealing. This judgment of the NCLAT has been upheld by the Supreme Court,¹⁶¹ and in other cases, the Supreme Court has gone on to hold that

*"46. The NCLAT has, while looking into viability and feasibility of resolution plans that are approved by the committee of creditors, always gone into whether operational creditors are given roughly the same treatment as financial creditors, and if they are not, such plans are either rejected or modified so that the operational creditors' rights are safeguarded. It may be seen that a resolution plan cannot pass muster under Section 30(2)(b) read with Section 31 unless a minimum payment is made to operational creditors, being not less than liquidation value... [This] further strengthens the rights of operational creditors by statutorily incorporating the principle of fair and equitable dealing of operational creditors' rights, together with priority in payment over financial creditors."*¹⁶²

The exact scope of the application of this principle is still evolving, and there needs to be more clarity on the manner in which fair and equitable dealing within a resolution plan would interact with pre-insolvency entitlements, especially of secured creditors. This was in issue in *Employees of Jyoti Structures Limited v. DBS Bank Ltd.*¹⁶³ In this case, DBS bank had first charge over the assets of the corporate debtor, such that the liquidation value of the assets was three times the debt owed to it. However, the resolution plan did not distinguish between the first chargeholder and the second chargeholder, and DBS bank was required to take a haircut *per* the terms of the resolution plan. The NCLAT held that DBS's objections to the resolution plan "*cannot be accepted as at the 'Resolution Process', 'Financial Creditor' claims are decided as per provision of the 'I&B Code'. All the 'Financial Creditors' are treated to be similar, if similarly situated.*" Therefore, the manner in which a resolution plan should deal fairly with first chargeholders is still unclear.

Conclusion

The priority of payments to be made pursuant to a resolution plan is not fixed. However, a resolution plan must balance the interests of all stakeholders. In doing this, the plan must deal with all creditors in a fair and equitable manner, including those creditors who do not have the right to vote on the resolution plan since they are not financial creditors. The plan must also not discriminate against equally situated creditors.

¹⁵⁹ *Binani Industries Ltd. &Anr. v. Bank of Baroda &Anr., Company Appeals (AT) (Insolvency) No. 82, 123, 188 of 2018. Decision date- 14.11.2018*

¹⁶⁰ *Ibid.*

¹⁶¹ *Rajputana Properties Pvt. Ltd. v. Ultratech Cement Ltd. &Ors., Civil Appeal No. 10998 of 2018. Decision date- 19.11.2018*

¹⁶² *Swiss Ribbons Pvt. Ltd. &Anr. v. Union of India, Writ Petition (Civil) No. 99 of 2018. Decision date- 25.01.2019*

¹⁶³ *Employees of Jyoti Structures Limited v. DBS Bank Ltd., Company Appeal (AT) (Insolvency) No. 461 of 2018. Decision date- 19.03.2019*

the fact that the *de facto* situation is not in line with the *de jure* situation.

It is not clear how the *de facto* situation is to be determined. The *de facto* situation is not necessarily the same as the *de jure* situation. The *de facto* situation is the situation that actually exists, regardless of what the law says. The *de jure* situation is the situation that is legally prescribed, regardless of what actually exists. The *de facto* situation is determined by the actual facts of the case, while the *de jure* situation is determined by the law.

The *de facto* situation is determined by the actual facts of the case. The *de jure* situation is determined by the law. The *de facto* situation is the situation that actually exists, regardless of what the law says. The *de jure* situation is the situation that is legally prescribed, regardless of what actually exists. The *de facto* situation is determined by the actual facts of the case, while the *de jure* situation is determined by the law.

The *de facto* situation is determined by the actual facts of the case. The *de jure* situation is determined by the law. The *de facto* situation is the situation that actually exists, regardless of what the law says. The *de jure* situation is the situation that is legally prescribed, regardless of what actually exists. The *de facto* situation is determined by the actual facts of the case, while the *de jure* situation is determined by the law.

The *de facto* situation is determined by the actual facts of the case. The *de jure* situation is determined by the law. The *de facto* situation is the situation that actually exists, regardless of what the law says. The *de jure* situation is the situation that is legally prescribed, regardless of what actually exists. The *de facto* situation is determined by the actual facts of the case, while the *de jure* situation is determined by the law.

The *de facto* situation is determined by the actual facts of the case. The *de jure* situation is determined by the law. The *de facto* situation is the situation that actually exists, regardless of what the law says. The *de jure* situation is the situation that is legally prescribed, regardless of what actually exists. The *de facto* situation is determined by the actual facts of the case, while the *de jure* situation is determined by the law.

The *de facto* situation is determined by the actual facts of the case. The *de jure* situation is determined by the law. The *de facto* situation is the situation that actually exists, regardless of what the law says. The *de jure* situation is the situation that is legally prescribed, regardless of what actually exists. The *de facto* situation is determined by the actual facts of the case, while the *de jure* situation is determined by the law.

www.vidhilegalpolicy.in
Vidhi Centre for Legal Policy
D-359, Defence Colony
New Delhi – 110024
011-43102767/43831699

www.ibbi.gov.in
Insolvency and Bankruptcy Board of India
7th floor, Mayur Bhawan, Connaught Circus
New Delhi – 110001
&
2nd floor, Jeevan Vihar Building, Parliament Street
New Delhi- 110001
011-23462900