ANALYSIS OF CASES PERTAINING TO THE INSOLVENCY AND BANKRUPTCY CODE, 2016

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The Insolvency and Bankruptcy Code, 2016, is an effective framework for timely resolution of insolvency and bankruptcy that would support development of credit markets and encourage entrepreneurship. Submission of a resolution plan or plans by the resolution applicants is an important step in this process. Approval of the resolution plan by the committee of creditors as well as the Adjudicating Authority is another vital process : if the resolution plans are not received or approved, the Adjudicating Authority under section 31 of the Code is empowered to initiate liquidation proceedings.

Approval of resolution plan

Section 30(4) of the Code carries a stipulation that the plan has to be approved by a specified percentage of the voting share of the financial creditors (75 per cent. substituted as 66 per cent. with effect from November 23, 2007). In *Kamineni Steel and Power India P. Ltd.* v. *Indian Bank* [2018] 211 Comp Cas 46 (NCLAT), the Appellate Tribunal relying on section 21(8) of the Code held that the provision which provided that all decisions were to be taken by the committee by a vote of not less than 75 per cent. (substituted as 51 per cent. with effect from June 6, 2018) was mandatory and approved the decision of the Adjudicating Authority passing an order of liquidation as the period of 270 days had elapsed without any resolution plan having been approved by not less than 75 per cent. of the vote shares of the committee of creditors. The decision was appealed against before the Supreme Court. The Supreme Court in a landmark judgment, *K. Sashidhar* v. *Indian Overseas Bank* [2019] 213 Comp Cas 356 (SC), dealt comprehensively with the process of approval of the resolution plan and also the scope of the Adjudicating Authority and the Appellate Tribunal to interfere with decisions of the committee.

Requisite percentage of voting share of financial creditors

The Supreme Court has held that the scrutiny of the resolution plan was required to pass through the litmus test of not less than the requisite percentage (75 per cent. or 66 per cent. as may be applicable) of the voting share, a strict regime. That meant the resolution plan must appear to not

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less than the requisite voting share of the financial creditors to be an overall credible plan, capable of achieving the timelines specified in the Code generally, assuring successful revival of the corporate debtor and disavowing endless speculation.

Prospective effect of substitution of threshold requirement of percentage of vote share

The court negated the submission of the resolution applicant that since the amendment substituted the threshold requirement of 75 per cent. to 66 per cent. and since it had been brought into force when the appeals were pending, the National Company Law Appellate Tribunal was obliged to consider its effect on the present cases. It was of the opinion that (page 404 of 213 Comp Cas) :

> ". . . a new norm and qualifying standard for approval of a resolution plan has been introduced. That cannot be treated as a declaratory/clarificatory or stricto sensu procedural matter as such. Whereas, the stated Amendment Act makes it expressly clear that it shall be deemed to have come into force on June 6, 2018. Thus, by mere use of expression 'substituted' in section 23(iii)(a) of the Amendment Act of 2018, it would not make the provision retrospective in operation or having retroactive effect. This interpretation is reinforced by the fact that there is no indication in the Amendment Act of 2018 that the Legislature intended to undo and/or govern the decisions already taken by the CoC of the concerned corporate debtors prior to June 6, 2018."

Recording of reasons of dissenting creditors

The court held that "non-recording of reasons for approving or rejecting the resolution plan by the concerned financial creditor during the voting in the meeting of the CoC, would not render the final collective decision of the CoC a nullity per se. Concededly, if the objection to the resolution plan is on account of infraction of ground(s) specified in sections 30(2) and 61(3), that must be specifically and expressly raised at the relevant time. For, the approval of the resolution plan by the CoC can be challenged on those grounds".

Scope of Adjudicating Authority or the Appellate Tribunal to intervene in commercial decision of the creditors

It was held that if the opposition to the proposed resolution plan was purely a commercial or business decision, it being non-justiciable, was not open to challenge before the Adjudicating Authority or the Appellate Tribunal. If so, non-recording of any reason for taking such commercial decision would be of no avail. Since in the case involved, the dissenting financial creditors had rejected the resolution plan in exercise of business/commercial decision and not because of non-compliance with the grounds specified in section 30(2) or section 61(3), the court held that the amended regulation 39(3) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, which provided that the committee shall record the reasons for approving or rejecting a resolution plan, would be of no avail.

Since the resolution plan of the concerned corporate debtor was not approved by the requisite per cent. of voting share of the financial creditors ; and in the absence of any alternative resolution plan having been presented within the statutory period of 270 days, the court was of the view that the inevitable sequel was to initiate the liquidation process under section 33 of the Code. Therefore the court held that the decision of the Appellate Tribunal was unexceptional.

Resolution process not adversarial

Another comprehensive landmark judgment was delivered by Justices Rohinton Fali Nariman and Navin Sinha in *Swiss Ribbons P. Ltd.* v. *Union of India* [2019] 213 Comp Cas 198 (SC), wherein the constitutional validity of various provisions of the Code was discussed. The court clarified that the resolution process under the Code was not adversarial to the corporate debtor but, in fact, protective of its interests.

Validity of appointment of Members of National Company Law Tribunal and National Company Law Appellate Tribunal

A committee for selection of members of the Tribunal and Appellate Tribunal was to be constituted in accordance with section 412 of the Companies Act, 2013, as amended by the Companies (Amendment) Act, 2017 and brought into force by a Notification dated February 9, 2018. A committee had been constituted in compliance with the directions of the Supreme Court in *Madras Bar Association* v. *Union of India* [2014] 187 Comp Cas 426 (SC) ; [2014] 368 ITR 42 (SC) and *Union of India* v. *R. Gandhi* [2010] 156 Comp Cas 392 (SC) in the year 2015. This Selection Committee was reconstituted on February 22, 2017 to make further appointments. In compliance with the directions of the Supreme Court, advertisements dated August 10, 2015 were issued inviting applications for Judicial and Technical Members as a result of which, all the present Members of the National Company Law Tribunal and National Company Law Appellate Tribunal were appointed. Therefore the validity of the appointment of the members were upheld by the Supreme Court.

Circuit Benches of Appellate Tribunal

Circuit Benches of the National Company Law Appellate Tribunal being a vital need for a country as vast as India the court directed the Central Government to set up Circuit Benches of the National Company Law Appellate Tribunal within a period of six months.

Administrative control of Tribunal and Appellate Tribunal

The observation of the Supreme Court in *Union of India* v. *R. Gandhi* [2010] 156 Comp Cas 392 (SC) that the administrative support for all Tribunals should be from the Ministry of Law and Justice and neither the Tribunals nor their Members should seek or be provided with facilities from the respective sponsoring or parent Ministries or Department concerned has not been implemented till now. Taking note of this fact, the court directed that this situation was to be rectified at the earliest.

Intelligible differentia between financial creditor and operational creditor

The legislative scheme contained in section 7 of the Code was challenged, stating that there is no real difference between financial creditors and operational creditors as both types of creditors would give either money in terms of loans or money's worth in terms of goods and services. On this basis, regard being had to the object sought to be achieved by the Code, namely, insolvency resolution, and if that is not possible, then ultimately, liquidation it was contended that such classification was not only be discriminatory, but also manifestly arbitrary, as under sections 8 and 9 of the Code, an operational debtor is not only given notice of default, but was entitled to dispute the genuineness of the claim, whereas in case of a financial debtor, no notice was given and the debtor was not entitled to dispute the claim of the financial creditor. It was enough that a default as defined occurs, after which, even if the claim was disputed and even if there be a set-off and counterclaim, yet, the Code was activated at the behest of a financial creditor, without the corporate debtor being able to justify the fact that a genuine dispute is raised, which ought to be left for adjudication before ordinary courts and/or Tribunals. Taking note of the shift in the legislative policy from the concept of "inability to pay debts" to "determination of default" which enabled the financial creditor to prove, based upon solid documentary evidence, that there was an obligation to pay the debt and that the debtor had failed in such obligation, the court observed that (page 240 of 213 Comp Cas) :

> "Since equality is only among equals, no discrimination results if the court can be shown that there is an intelligible differentia which

separates the two kinds of creditors so long as there is some rational relation between the creditors so differentiated, with the object sought to be achieved by the legislation."

The following distinct features between the financial creditors and the operational creditors were pointed out :

(i) Financial creditors, which involved banks and financial institutions, would certainly be smaller in number than operational creditors of a corporate debtor.

(ii) Most financial creditors, particularly banks and financial institutions, were secured creditors whereas most operational creditors were unsecured, payments for goods and services as well as payments to workers not being secured by mortgage documents and the like.

(iii) The nature of loan agreements with financial creditors was different from that of contracts with the operational creditors for supplying goods and services.

(iv) Financial creditors generally lend finance on a term loan or for working capital that enabled the corporate debtors to either set up or operate its business. On the other hand, contracts with the operational creditors are relatable to supply of goods and services in the operation of business.

(v) Financial contracts generally involved large sums of money. By way of contrast, operational contracts had dues whose quantum was generally less.

(vi) Financial creditors had specified repayment schedules, and defaults entitle the financial creditors to recall a loan in totality. Contracts with the operational creditors did not have any such stipulations.

(vii) The forum in which dispute resolution takes place is completely different. Contracts with the operational creditors could and did have arbitration clauses where dispute resolution was done privately.

(viii) Operational debts also tend to be recurring in nature and the possibility of genuine disputes in the case of operational debts was much higher when compared to financial debts. On the other hand, financial debts to banks and financial institutions were well-documented and defaults were easily verifiable.

Apart from the above the court felt that the most important factor was that the financial creditors were, from the very beginning, involved with assessing the viability of the corporate debtors. They could, and therefore did, engage in restructuring of the loan as well as reorganisation of the corporate debtors' business when there was financial stress, which were things the operational creditors did not and could not do. Thus, preserving the corporate debtors as a going concern, while ensuring maximum recovery for all creditors being the objective of the Code, the financial creditors were clearly different from the operational creditors. It was, therefore held, there was obviously an intelligible differentia between the two which had a direct relation to the objects sought to be achieved by the Code. Since the National Company Law Tribunal, while looking into the viability and feasibility of resolution plans that were approved by the committee of creditors, always went into whether the operational creditors were given roughly the same treatment as the financial creditors, and if they were not, such plans were either rejected or modified so that the operational creditors' rights were safeguarded, it was also held that operational creditors were not discriminated against and that article 14 of the Constitution of India was not infracted either on the ground of equals being treated unequally or on the ground of manifest arbitrariness.

Withdrawal of petition

Section 12A was inserted by the Insolvency and Bankruptcy (Second Amendment) Act, 2018 with retrospective effect from June 6, 2018 based on the ILC Report of March 2018. The validity of this section was dealt with by the court in paragraphs 50 to 53 of the judgment. It was held that once the Code gets triggered by admission of a creditor's petition under sections 7 to 9 of the Code, the proceeding that was before the Adjudicating Authority, being a collective proceeding, was a proceeding in rem. Being a proceeding in rem, it was necessary that the body which was to oversee the resolution process be consulted before any individual corporate debtor was allowed to settle its claim. It was clarified that at any stage where the committee of creditors was not yet constituted, a party could approach the National Company Law Tribunal directly, which the Tribunal may, in exercise of its inherent powers under rule 11 of the National Company Law Tribunal Rules, 2016, after hearing all the concerned parties and considering all relevant factors on the facts of each case, allow or disallow an application for withdrawal or settlement. The constitutional validity of section 12A of the Code was upheld.

The decision of the Supreme Court in *Brilliant Alloys P. Ltd.* v. *S. Rajagopal* [2019] 213 Comp Cas 196 (SC) was also referred to. Whether regulation 30A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, which provides that the application for withdrawal of petition in terms of section 12A should be made by the interim resolution professional or the resolution professional before the issue of invitation of expression of interest under regulation 36A was to be strictly followed was the issue before the

Supreme Court in *Brilliant Alloys P. Ltd.* v. *S. Rajagopal* [2019] 213 Comp Cas 196 (SC). The court held that regulation 30A was to be read along with the main provision section 12A of the Code which contained no such stipulation. It was of view that the stipulation could only be construed as directory depending on the facts of each case. The decision of the Adjudicating Authority in *Vimal Chandrunwal* v. *Brilliant Alloys P. Ltd.* [2019] 213 Comp Cas 195 (NCLT) was reversed. Interestingly in *Praveen Arjun Patel* v. *JK Lakshmi Cement Ltd.* [2018] 4 Comp Cas-OL 198 (NCLAT), the Appellate Tribunal had held that section 12A of the Code would not be applicable if admission of the petition had been challenged.

Evidentiary value of information from information utilities

A challenge to the evidential value of information from private information utilities was also negated by the court. The court took note of the stringent requirements in regulations 20 and 21 of the Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017 and the requirement of the utility to expeditiously undertake the process of authentication and verification of information, which included authentication and verification from the debtor who had defaulted. The fact that such evidence, was only prima facie evidence of default, which was rebuttable by the corporate debtor was also considered.

Powers of resolution professional

Upon consideration of section 18 of the Code and regulations 10, 12, 13, 14, 35A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and on contrasting them with sections 38 to 42 of the Code, it was observed that the resolution professional was really a facilitator of the resolution process, whose administrative functions are overseen by the committee of creditors and by the Adjudicating Authority. The resolution professional had no adjudicatory powers.

Disqualification of resolution applicant

Section 29A of the Code deals with the eligibility of an applicant to submit a resolution plan. In *Chitra Sharma* v. *Union of India* [2018] 210 Comp Cas 609 (SC), the Supreme Court held that persons responsible for the insolvency of a corporate debtor could not participate in the resolution process and the promoters of the corporate debtor and its holding company were barred from participating in its resolution process. In *ArcelorMittal India P. Ltd.* v. *Satish Kumar Gupta* [2018] 211 Comp Cas 369 (SC), the Division Bench of the Supreme Court of which Justice Rohinton Fali Nariman was a member, inter alia, held that it was important to lift the corporate veil and see the person in "control" of the resolution applicant. It held that the stage of ineligibility under section 29A(c) of the Code attached when the resolution applicant submitted the resolution plan and the date of commencement of the insolvency resolution process was only relevant for the purpose of calculating whether one year lapsed from the date of classification of such person as non-performing asset. In *Swiss Ribbons P. Ltd.* v. *Union of India* [2019] 213 Comp Cas 198 (SC), the Supreme Court reiterated its point as clarified in *ArcelorMittal India P. Ltd.* v. *Satish Kumar Gupta* [2018] 211 Comp Cas 369 (SC) that any person who wished 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 mentioned, must first pay off the debt of the corporate debtor classified as a non-performing asset in order to become eligible under section 29A(c). The prescription that a person unable to service its own debt within the prescribed period was unfit to be a resolution applicant did not take away any vested interest. The court clarified that "connected person" meant persons, natural as well as artificial, connected with the business activity of the resolution applicant and the expressions "related party" and "relative" were to be read noscitur a sociis with the categories of persons mentioned in *Explanation I* to section 29A(j) and included only persons who are connected with the business activity of the resolution applicant. The court (in paragraph 75 at page 299 of 213 Comp Cas) observed 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) showed 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. In the absence of showing that such person is 'connected' with the business of the activity of the resolution applicant, such person cannot possibly be disqualified under section 29A(j). All the categories in section 29A(j) deal with persons, natural as well as artificial, who are connected with the business activity of the resolution applicant. 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".

Exemption of micro, small, and medium enterprises from section 29A

The exclusion of micro, small, and medium industries from the application of section 29A(c) and (h) was found to be for valid reason and based on the Insolvency Law Committee Report.

Positive impact of Code

The Supreme Court took note of the positive impact of the Code and in its conclusion observed that (page 305 of 213 Comp Cas) :

> "The experiment contained in the Code, judged by the generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster. To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation. We have also seen that the working of the Code is being monitored by the Central Government by the expert committees that have been set up in this behalf. Amendments have been made in the short period in which the Code has operated, both to the Code itself as well as to subordinate legislation made under it. This process is an ongoing process which involves all stakeholders, including the petitioners.
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> We are happy to note that in the working of the Code, the flow of financial resource to the commercial sector in India has increased exponentially as a result of financial debts being repaid. Approximately 3,300 cases have been disposed of by the Adjudicating Authority based on out-of-court settlements between the corporate debtors and creditors which themselves involved claims amounting to over INR 1,20,390 crores. Eighty cases have since been resolved by resolution plans being accepted. Of these eighty cases, the liquidation value of sixty-three such cases is INR 29,788.07 crores. However, the amount realized from the resolution process is in the region of INR 60,000 crores, which is over 202 per cent. of the liquidation value. As a result of this, the Reserve Bank of India has come out with figures which reflect these results. Thus, credit that has been given by the banks and financial institutions to the commercial sector (other than food) has jumped up from INR 4,952.24 crores in 2016-17, to INR 9,161.09 crores in 2017-18, and to INR 13,195.20 crores for the first six months of 2018-19. Equally, credit flow from non-banks has gone up from INR 6,819.93 crores in 2016-17, to INR 4,718 crores for the first six months of 2018-19. Ultimately, the total flow of resources to the

> commercial sector in India, both bank and non-bank, and domestic and foreign (relatable to the non-food sector) has gone up from a total of INR 14,530.47 crores in 2016-17, to INR 18,469.25 crores in 2017-18, and to INR 18,798.20 crores in the first six months of 2018-19. These figures show that the experiment conducted in enacting the Code is proving to be largely successful. The defaulter's paradise is lost."

Most definitely the experiment conducted in enacting the Code has proved to be largely successful.

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