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

POORNIMA (N.)[1]

Overriding effect of Code

The non obstante clause in section 238 in the Insolvency and Bankruptcy Code, 2016, provides that the provisions of the Code shall have overriding effect over any inconsistent provisions contained in any other law for the time being in force or any instrument having effect by virtue of any such law. In *J. Manivannan* v. *Deputy Superintendent of Police, Economic Offences Wing* [2019] 215 Comp Cas 89 (NCLT), the provisions of the Tamil Nadu Protection of Interest of Depositors (in Financial Establishments) Act, 1997, being a State legislation had to give way to the provisions of the Code which was a special Central legislation. The Competent Authority and the Investigation Officer under the 1997 Act were directed to hand over all the records of the corporate debtor including books of account along with chits security deposits amounting to Rs. 2.71 crores to the resolution professional in order to enable him to carry out his duties in accordance with the Insolvency and Bankruptcy Code, 2016. In *Bhanu Ram* v. *HBN Dairies and Allied Ltd.* [2019] 7 Comp Cas-OL 360 (NCLT), the corporate debtor illegally collected money to the tune of Rs. 1,136 crores under its unauthorised "collective investment schemes". A recovery certificate dated September 14, 2017 for an amount of Rs. 1,136 crores was drawn up against the debtor pursuant to orders passed by the Securities and Exchange Board of India as confirmed by the Securities Appellate Tribunal. Thereafter, the immovable properties held by the "corporate debtor" were attached by an order dated September 29, 2017 passed by the Recovery Officer. A group of investors were frustrated by the long delay due to action of the Board and filed a joint petition under section 7 of the Code for initiating the corporate insolvency resolution process. The Adjudicating Authority admitted the petition despite the plea of the debtor that since the Board had already taken action against it, the petition under section 7 was not maintainable and that the petitioners were not "financial creditors". In *Bohar Singh Dhillon* v. *Rohit Sehgal, Interim Resolution Professional* [2019] 215 Comp Cas 355 (NCLAT), the Appellate Tribunal affirmed the

1. B.Com, LL.B, Consultant.

decision of the Adjudicating Authority. It held in view of section 238 of the Code, the petition under section 7 was maintainable. It further held that as long as the moratorium continued, the Securities and Exchange Board of India could not recover any amount or sell the assets of the corporate debtor.

The Tea Act, 1953 is an Act to provide for the control by the Union of the tea industry, including the control, in pursuance of the international agreement now in force, of the cultivation of tea in, and of the export of tea from, India and for that purpose to establish a Tea Board and levy a duty of excise on tea produced in India. Section 16G(1)(c) of the Act provides that no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court except with the consent of the Central Government. In *A. J. Agrochem* v. *Duncans Industries Ltd.* [2019] 215 Comp Cas 361 (NCLT), a question arose whether permission of the Central Government was required to initiate proceedings under the Code against a tea company. The Adjudicating Authority noticed that in terms of section 238 of the Code the provisions of the Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law. It was of the view that the 1953 Act is a special legislation that governed the tea industry and tea companies while the Code deals with general provisions relating to insolvency and bankruptcy of companies and individuals in India. Since the two statutes did not occupy the same field, it held that there were no inconsistent provisions in the 1953 Act, which may give overriding effect to the provisions of the Code. The Adjudicating Authority dismissed the petition on the ground that permission of the Central Government was not obtained. This part of the order was reversed by the Appellate Tribunal in *A. J. Agrochem* v. *Duncans Industries Ltd.* [2019] 215 Comp Cas 367 (NCLAT). The Appellate Tribunal made a distinction between the resolution process to revive the corporate debtor under the Code and winding up and held that section 9 of the Code occupied a different field than section 16G(1) of the 1953 Act and there was no conflict between these provisions. Therefore, it held that consent of the Central Government was not essential.

Who is a financial creditor ?

According to section 3(10) of the Code a "creditor" means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decree holder. Section 5(7) states that a "financial creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been

legally assigned or transferred. Thus it is clear that a person to whom a financial debt is legally assigned or transferred can step into the shoes of a financial creditor and initiate proceedings against the corporate debtor under the provisions of the Code. In *Reliance Commercial Finance Ltd.* v. *Maximum Synthetic P. Ltd.* [2019] 215 Comp Cas 97 (NCLT), the status of the petitioner to file a petition under section 7 of the Code was questioned by the debtor. The Adjudicating Authority took note of the fact that a scheme of arrangement had been sanctioned by the High Court between the original lender of the corporate debtor and the petitioner in terms of which all the powers, rights and liabilities and other consequences relating to the commercial finance business of the transferor stood demerged and transferred to the petitioner. The Authority was of the view that though as claimed by the corporate debtor, there was no assignment of a right or debt or financial assets from the erstwhile lender to the petitioner in terms of the guidelines issued by the Reserve Bank of India, the petitioner legally took the position of the original lender inheriting all rights, liabilities and powers to take any action as the original lender. Thus, the petitioner was held to be a financial creditor in terms of section 7 of the Code.

A shareholder, director or promoter of the corporate debtor can also be a financial creditor when he repays the loan that has been advanced by the bank to the corporate debtor. The Adjudicating Authority in *Mrs. Anita Kumaran* v. *KGS Developers Ltd.* [2019] 215 Comp Cas 310 (NCLT) was of the view that the intention of the Legislature did not appear to be to exclude shareholders and directors or promoters, who might have given loan to the corporate debtor or repaid the loan on behalf of the corporate debtor, from the purview of the definition of the "financial creditor" or "financial debt". On the facts, the Adjudicating Authority held that the petitioners being a shareholder and director had made payments of the loan taken by the corporate debtor from the bank and had given collateral security by way of mortgage to the bank which fell within the purview of the term, "any other instrument" under section 5(8)(h)[1] of the Code which defines the term "financial debt". The petition was held maintainable and was admitted on the facts.

Non-banking financial institution

In terms of section 6 of the Code proceeding under sections 7, 9 and 10 of the Code can be initiated against a corporate debtor who defaulted in payment of its debt. Who is a corporate debtor has been answered by

1. Section 5(8)(h) : "any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution ;"

section 3(8) of the Code as a corporate person who owes a debt to any person. This can lead to a question who is a corporate person. Section 3(7) defines the terms as :

> "a company as defined in clause (20) of section 2 of the Companies Act, 2013 (18 of 2013), a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009), or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider."

A careful reading of this section reveals that "any financial service provider" has been specifically excluded under the definition even if it is covered under the earlier part of the definition. The Adjudicating Authority in *HDFC Ltd.* v. *RHC Holding P. Ltd.* [2019] 6 Comp Cas-OL 125 (NCLT) dismissed the petition filed by a financial creditor relying on this definition and held that the respondent-company being a non-banking financial institution rendering financial service was outside the purview of the Code. This decision has been affirmed by the Appellate Tribunal in *Housing Development Finance Corporation Ltd.* v. *RHC Holding P. Ltd.* [2019] 215 Comp Cas 228 (NCLAT). The Appellate Tribunal observed that the issue relating to taking of deposits in violation of conditions imposed by the Reserve Bank of India could not be decided by the Adjudicating Authority while considering a petition under section 7 or 9 of the Code and that if the terms and conditions imposed by the Reserve Bank of India were contravened or there was violation of any of the provisions of the Reserve Bank of India, it should be brought to the notice of the Reserve Bank of India and not the Adjudicating Authority.

Dispute must be bona fide

In *Sarla Tantia* v. *Ramaanil Hotels and Resorts P. Ltd.* [2018] 210 Comp Cas 225 (NCLT), the Adjudicating Authority held that arrears of rent arising out of an agreement to license premises are not excluded from the purview of "operational debt" as defined in section 5(21) of the Insolvency and Bankruptcy Code, 2016. However, the Authority dismissed the petition filed by the operational creditor on the ground that a bona fide dispute existed prior to the date of issuance of the demand notice regarding the area of demised premises and the rate of rent liable to be paid. The operational creditor's appeal was allowed by the Appellate Tribunal in *Sarla Tantia* v. *Ramaanil Hotels and Resorts P. Ltd.* [2019] 215 Comp Cas 244 (NCLAT). The Appellate Tribunal took note of the fact that the leave and licence agreement entered into between the parties clearly provided for calculation of rent on the basis of the super built area and also contained

an arbitration clause. And since the corporate debtor had been making payment on the basis of the super built area it held that it could not claim that rent was payable on the carpet area. The fact that the debtor failed to invoke the arbitration clause or reply to the demand notice was held against it. It observed that the contractual relations inter se the parties was governed by the leave and licence agreement and did not admit of any oral agreement contrary to the stipulations therein. The defence raised by the debtor was found to mere moonshine. Since the debt and default were established, the Adjudicating Authority was directed to admit the petition after providing opportunity to the corporate debtor to settle the claim.

Existence of debt

A debt has to exist in the first place in order to become due and the corporate debtor must commit a default in payment of such debt which is due for any creditor or the debtor itself to invoke the provisions of the Code. Section 186(2) of the Companies Act, 2013 provides that no company shall directly or indirectly (a) give any loan to any person or other body corporate, (b) give any guarantee or provide security in connection with a loan to any other body corporate or person, and (c) acquire by way of subscription, purchase or otherwise, the securities of any other body corporate, exceeding sixty per cent. of its paid-up share capital, free reserves and securities premium account or one hundred per cent. of its free reserves and securities premium account, whichever is more. Sub-section (3) of this section also provides that in case the limit mentioned in sub-section (2) is exceeded a special resolution passed in a general meeting is necessary. Therefore, it is essential that a company which is providing financial assistance to the corporate debtor show that these provisions were complied with before any amount paid by it could be termed a financial debt. Since there was nothing on record to show that the financial creditor had advanced the loan after complying with these conditions, the Adjudicating Authority in *SKDJ Dream Home P. Ltd.* v. A*vinash Raj Constructions P. Ltd.* [2019] 215 Comp Cas 322 (NCLT) held that the transaction as claimed by the financial creditor against the corporate debtor could not be recognized as a transaction of loan or a financial debt.

In *Alok Jain* v. *Tijaria Polypipes Ltd.* [2019] 215 Comp Cas 374 (NCLAT) this principle was reiterated by the Appellate Tribunal which was of the view that in order to trigger the provisions of the Code, on the basis of section 9, it is necessary for the operational creditor to show that there is an outstanding operational debt and that there is a default. The order of the Adjudicating Authority in *Alok Jain* v. *Tijaria Polypipes Ltd.* [2019] 7 Comp Cas-OL 373 (NCLT) was affirmed and the petition was dismissed on the

ground that the creditor had failed to show the existence of an operational debt.

Consent of shareholders

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 substituted section 10 of the Code with effect from June 6, 2018. The requirement of a special resolution to be passed by the shareholders of the corporate debtor to initiate the corporate insolvency resolution process by a corporate applicant under section 10 of the Code was introduced in section 10(3)(c). Whether this provision had retrospective effect was considered by the Adjudicating Authority in *Supraja Textiles P. Ltd., In re* [2019] 215 Comp Cas 436 (NCLT). It held that there was no provision in the Code prior to June 6, 2018 that required a special resolution and this was for the first time introduced by way of an Ordinance replacing the earlier section 10(3). Therefore, it was not a case where an existing right had been taken away but a case where a special condition was made applicable for filing of applications by corporate applicants under section 10 of the Code. Since a new condition was brought into the Code by way of amendment, it was held that such condition could not be given retrospective effect. The petition was filed on May 9, 2018 much prior to the coming into force of the amended section 10(3)(c), which came into force on June 6, 2018. Therefore, the corporate applicant was not directed to take the approval of the shareholders by applying the amended section 10(3)(c) of the Code. The Adjudicating Authority was of the view that special precaution taken by the Legislature could only be given prospective effect and the amended section 10(3)(c) if given retrospective effect on the ground that it was procedural one, would give rise to a new obligation and impose a new duty on petitioners who had already filed petitions under section 10 of the Code prior to June 6, 2018.

Liquidation order

An order of liquidation under section 33(1) of the Code can be passed if before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the corporate insolvency resolution process under section 12 or the fast track corporate insolvency resolution process under section 56, as the case may be, a resolution plan under sub-section (6) of section 30 is not received or is rejected under section 31 for the non-compliance with the requirements specified therein. The promoter of the corporate debtor filed an appeal challenging the order passed by the Adjudicating Authority in *R. Venkatakrishnan, Resolution Professional, BKR Hotels and Resorts P. Ltd., In re* [2019] 7 Comp Cas-OL

81 (NCLT) by which it directed liquidation of the debtor, on the ground that the debtor could be saved from liquidation if a plan, which was with the promoter was accepted. The Appellate Tribunal in *D. R. Balakrishna Raja* v. *Indian Bank* [2019] 215 Comp Cas 144 (NCLAT) refused to interfere with the Adjudicating Authority's order as more than 270 days had passed and in the absence of any viable and feasible resolution plan, there was no option to the Adjudicating Authority, but to pass an order under section 33 of the Code. It was clarified that it would be open to the appellant or members to propose any arrangement or scheme in terms of section 230 of the Companies Act, 2013. This is in line with observation of the Appellate Tribunal in *Y. Shivram Prasad* v. *S. Dhanapal* [2019] 214 Comp Cas 83 (NCLAT) to the effect that during the liquidation stage, the liquidator was required to take steps to ensure that the company remained a going concern and instead of liquidation and for revival of the corporate debtor by taking certain measures including steps in terms of section 230 of the 2013 Act.
