Apex Court Reverses NCLAT's Order – A Sign of Relief!!

In the present article, the author has dealt in detail and analysed the judgement of the Supreme Court in the case of Macquarie Bank Limited vs. Shilpi Cable Technologies Ltd. wherein the Court has reversed the orders passed by the National Company Law Appellate Tribunal which took a very strict interpretation of law without getting into the nitty-gritty of the provisions of the Insolvency and Bankruptcy Code, 2016 and the objective with which the Code was articulated. Read on to know more….

The Insolvency and Bankruptcy Code, 2016 ("Code"), has been formulated with an objective to re-organise insolvency resolution in a time bound manner, maximise the value of assets and balance the interest of all the stakeholders. With the increase in the number of applications and the questions on how the provisions of the Code shall be interpreted, the National Company Law Tribunal ("NCLT") and National Company Law Appellate Tribunal ("NCLAT") in various applications and appeals, took a very strict interpretation of law without getting into the nitty-gritty of the provisions of the Code and the objective with which the Code was articulated.

The Supreme Court of India reversed the orders passed by NCLAT in *Macquarie Bank Limited vs. Shilpi Cable Technologies Ltd.*[1], *Civil Appeal No. 15135 of 2017*, answered two important questions and re-iterated the duty of a Judge, *"The task of a Judge, when he looks at the literal language of the statute as well as the object and purpose of the statute, is not to interpret the provision as he likes but is to interpret the provision keeping in mind Parliament's language and the object that Parliament had in mind. With this caveat, it is clear that judges are not knight-errants free to roam around in the interpretative world doing as each Judge likes. They are bound by the text of the statute, together with the context in which the statute is enacted; and both text and context are Parliaments', and not what the Judge thinks the statute has been enacted for."*

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Facts of the Case:

The facts contained in Company Appeal No. 15447[2] of 2017 and 15481[3] of 2017 are similar; therefore, the Supreme Court considered the facts as set out in Company Appeal No. 15481 of 2017. As per the terms, payment was to be received by Macquarie Bank Limited ('Appellant') within a period of 150 days from the date of bill of lading. Several emails by way of reminders were sent by the Appellant to Shilpi Cable Technologies Ltd. ('Respondent') but the Appellant failed to receive any payment.

[1] http://supremecourtofindia.nic.in/supremecourt/2017/29095/29095_2017_Judgement_15-Dec-2017.pdf
[2] http://supremecourtofindia.nic.in/php/case_status/case_status_process.php?d_no=29110&d_yr=2017
[3] http://supremecourtofindia.nic.in/php/case_status/case_status_process.php?d_no=27496&d_yr=2017

Subsequently, a statutory notice under Section 433 and 434 of the Companies Act, 1956 was issued by the Appellant; however, the Respondent *vide* its reply dated October 5, 2016 denied the fact that there was any outstanding amount.

Post enactment of the Code, the list of events that took place has been enumerated below:

14.2.2017	• Appellant issued a demand notice under Section 8 of the Code • Calling upon it to pay the outstanding amount of US$6,321,337.11
22.2.2017	• Respondent replied stating that nothing was owed by them to the Appellant • Questioned the validity of the purchase agreement dated 27.7.2015
7.3.2017	• Appellant initiated the insolvency proceedings by filing a petition under Section 9 of the Code
1.6.2017	• NCLT rejected the petition holding that Section 9(3)(c) of the Code was not complied • NCLT found that the dispute was raised by the reply to the notice under Section 433 and 434 of the Act, 1956 and held that the application is to be dismissed under Section 9(5)(ii)(d) of the Code
17.7.2017	• NCLAT held that Section 9(3)(c) of the Code being mandatory provision, application needs to be rejected • Advocates/Lawyers cannot issue notice under Section 8 of the Code on behalf of the operational creditor

Provisions of Law:

Code:

Section 3(14) of the Code defines the term 'financial institution' as follows:

(14) "financial institution" means –

(a) a scheduled bank;

(b) financial institution as defined in Section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934);

(c) public financial institution as defined in clause (72) of Section 2 of the Companies Act, 2013 (18 of 2013); and

(d) such other institution as the Central Government may by notification specify as a financial institution;

Application for Initiation of Corporate Insolvency Resolution Process by Operational Creditor

9. (1) After the expiry of the period of ten days from the date of delivery of the notice or invoice demanding payment under sub-Section (1) of Section 8, if the operational creditor does not receive payment from the corporate debtor or notice of the dispute under sub-Section (2) of Section 8, the operational creditor may file an application before the Adjudicating Authority for initiating a corporate insolvency resolution process.

(2) The application under sub-Section (1) shall be filed in such form and manner and accompanied with such fee as may be prescribed.

(3) The operational creditor shall, along with the application furnish –

(a) a copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor;

(b) an affidavit to the effect that there is no notice given by the corporate debtor relating to a dispute of the unpaid operational debt;

(c) a copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor; and

(d) such other information as may be specified.

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An operational creditor shall make an application for initiating the corporate insolvency resolution process against a corporate debtor under Section 9 of the Code in Form 5, accompanied with documents and records required therein and as specified in the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 ("AAA Rules")

Application by operational creditor

6. (1) An operational creditor, shall make an application for initiating the corporate insolvency resolution process against a corporate debtor under Section 9 of the Code in Form 5, accompanied with documents and records required therein and as specified in the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

(2) The applicant under sub-rule (1) shall dispatch forthwith, a copy of the application filed with the Adjudicating Authority, by registered post or speed post to the registered office of the corporate debtor.

Form 5

Instructions at the end of the form:

Please attach the following to this application:
Annex I Copy of the invoice/demand notice as in Form 3 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 served on the corporate debtor.
Annex II Copies of all documents referred to in this application.
Annex III Copy of the relevant accounts from the banks/financial institutions maintaining accounts of the operational creditor confirming that there is no payment of the relevant unpaid operational debt by the operational debtor, if available.
Annex IV Affidavit in support of the application in accordance with the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016.

Points of Discussion:

1. Whether, in relation to an operational debt, the provision contained in Section 9(3)(c) of the Code is mandatory; and
2. Whether a demand notice of an unpaid operational debt can be issued by a lawyer on behalf of the operational creditor.

Supreme Court's Judgement:

While both the points referred above were discussed in detail before pronouncing the judgement, certain points which were raised by the Appellant/ Respondent were clarified by the Apex Court. The discussion on the basis of which the judgement was pronounced are -

Section 9(3)(c) Provision is Mandatory?

Position of rules:

As evident from the facts of the case that Section 9 of the Code requires the operational creditor to submit the certified copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor. On the contrary, Annex III to Form 5 provides an opportunity to such creditor to submit the copy of relevant accounts of the bank/ financial institution, if available.

The Respondent's council placed reliance on various rulings which held that rules cannot override the substantive provisions of an Act; however, Supreme Court clarified that the referred judgements only have application when rules are *ultra vires* the parent statute. And, held that in the present case, *"the rules merely flesh out what is already contained in the statute and must, therefore, be construed along with the statute…..The true construction of Section 9(3)(c) is that it is a procedural provision which is directory in nature, as the Adjudicating Authority Rules read with the Code clearly demonstrate."*

Foreign Operational Creditor: Applicability of the Code

The definition of operational creditor reads as *"a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred"*. Notably, the definition of 'person' includes person resident outside India; therefore, the argument that such person ought to be left out of the triggering of the Code against their corporate debtor, despite being operational creditor was not found appropriate in terms of Article 14 of the Constitution of India. The Supreme Court held that, *"the Code cannot be construed in a discriminatory fashion so as to include only those operational creditors who are residents outside India who happen to bank/financial institutions which may be included under Section 3(14) of the Code….Therefore, as the facts of these cases show, a so called condition precedent impossible of compliance cannot be put as a threshold bar to the processing of an application under Section 9 of the Code."*

Bank Certificate: Mandatory or Directory

The provisions of the Code were argued on various grounds. One being, the expression "initiation" and

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"shall" lead to a conclusion that Section 9(3) contains mandatory conditions. Though the expression "initiation" indicates the drift of the provision, but an argument cannot be built from such drift. Accordingly, it was held that, *"Section 9(3)(c) becomes impossible of compliance in cases like the present. It would amount to a situation wherein serious general inconvenience would be caused to innocent persons, such as the appellant, without very much furthering the object of the Act, as has been held in the State of Haryana vs. Raghubir Dayal*[4] *(1995) 1 SCC 133 at paragraph 5*[5] *and obviously, therefore, Section 9(3)(c) would have to be construed as being directory in nature."*

It was further argued that the Code leads to very drastic action being taken once an application for insolvency is filed and admitted and that, therefore, all conditions precedent must be strictly construed; however, the same was not found to be in sync with the recent trend of authorities which concluded that the modern trend of case law is that creative interpretation is within the *Lakshman Rekha* of the Judiciary. Creative interpretation is when the Court looks at both the literal language as well as the purpose or object of the statute, in order to better determine what the words used by the draftsman of the legislation mean. The Supreme Court held that, *"fair construction of Section 9(3)(c), in consonance with the object sought to be achieved by the Code, would lead to the conclusion that it cannot be construed as a threshold bar or a condition precedent."*

Principle of Taylor

The principle of Taylor means that where a statute states that a particular act is to be done in a particular manner; it must be done in that manner or not at all. It was argued that the application of the principle in Taylor should be followed when it comes to the correct interpretation of Section 9(3)(c) of the Code. However, it was held that Section 8 of the Code does not prescribe any particular method of proof of occurrence of default. Consequently, the Supreme Court was of the opinion that the principle contained in Taylor does not apply in the present situation.

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Can Lawyers Issue Demand Notice on Behalf of Operational Creditors?

The use of expression "delivering"

It was noticed that Section 8 of the Code speaks of an operational creditor delivering a demand notice. Had it been the intention of the legislature to restrict such demand notice being sent by the operational creditor himself, the expression used would perhaps have been "issued" and not "delivered".

The expression delivery would include the notice being made by an authorised agent. Also, the forms require signature of the person "authorised to act" on behalf of the operational creditor must be appended to both the demand notice as well as the application under Section 9 of the Code, which further clarifies that it was never the intent of the law to restrict such delivery by only operational creditors.

The expression "in relation to" specifically includes a position which is outside or indirectly related to the operational creditor. The Supreme Court held that, *"both the expression "authorised to act" and "position in relation to the operational creditor" go to show that an authorised agent or a lawyer acting on behalf of his client is included within the aforesaid expression."*

Doctrine of Harmonius Constructions

[6]Where in an enactment, there are two provisions which cannot be reconciled with each other, they should be so interpreted that, if possible, effect may

[4] https://indiankanoon.org/doc/718040/

[5] Ibid. Para 5: The use of the word 'shall 'is ordinarily mandatory but it is sometimes not so interpreted if the scope of the enactment, on consequences to flow from such construction would not so demand. Normally, the word 'shall' *prima facie* ought to be considered mandatory but it is the function of the court to ascertain the real intention of the legislature by a careful examination of the whole scope of the statute, the purpose it seeks to serve and the consequences that would flow from the construction to be placed thereon. The word 'shall', therefore, ought to be construed not according to the language with which it is clothed but in the context in which it is used and the purpose it seeks to serve. The meaning has to be ascribed to the word 'shall' as mandatory or as directory, accordingly. Equally, it is settled law that when a statute is passed for the purpose of enabling the doing of something and prescribes the formalities which are to be attended for the purpose, those prescribed formalities which are essential to the validity of such thing, would be mandatory. However, if by holding them to be mandatory, serious general inconvenience is caused to innocent persons or general public, without very much furthering the object of the Act, the same would be construed as directory.

[6] http://www.icsi.edu/Webmodules/Publications/General%20&%20Commercial%20Laws.pdf – Pg. No. 75.

be given to both. This is what is known as the "rule of harmonius construction".

Section 30 of the Advocates Act permits the advocate to practise which would include all preparatory steps leading to the filing of an application before a Tribunal. Section 238 being a non-obstante clause can override the Advocates Act, in this regard, the Supreme Court held that, *"Since there is no clear disharmony between the two Parliamentary statutes in the present case which cannot be resolved by harmonious interpretation, it is clear that both statutes must be read together. Also, we must not forget that Section 30 of the Advocates Act deals with the fundamental right under Article 19(1)(g) of the Constitution to practice one's profession. Therefore, a conjoint reading of Section 30 of the Advocates Act and Sections 8 and 9 of the Code together with the Adjudicatory Authority Rules and Forms thereunder would yield the result that a notice sent on behalf of an operational creditor by a lawyer would be in order."*

Overriding Effect of Notwithstanding Clause

Various case laws were relied upon to determine when the notwithstanding clause will have an overriding effect. In *Balchand Jain vs. State of Madhya Pradesh*[7] (1976) SCC (4) 572 at 585-86, the anticipatory bail provision contained in Section 438 of the Code of Criminal Procedure was held not to be wiped out by the *non-obstante* clause contained in Rule 184 of the Defence and Internal Security of India Rules, 1971 as there did not appear to be any direct conflict between the provisions of Rule 184 of the Rules and Section 438 of the Code.

In *R. S. Raghunath vs. State of Karnataka* (1992) 1 SCC 335 at 348, the *non-obstante* clause contained in Rule 3(2) of the Karnataka Civil Services (General Recruitment) Rules, 1977 was held not to override the Karnataka General Service (Motor Vehicles Branch) (Recruitment) Rules, 1976, since the inconsistency was not clear between the two enactments before giving an overriding effect to the *non-obstante* clause and was also held that when the scope of the provisions of an earlier enactment is clear the same cannot be cut down by resort to non-obstante clause.

Consequently, in the present case, the Hon'ble Supreme Court held that, *"since there is no clear disharmony between the two Parliamentary statutes in the present case which cannot be resolved by harmonious interpretation, it is clear that both statutes must be read together. Also, we must not forget that Section 30 of the Advocates Act deals with the fundamental right under Article 19(1)(g) of the Constitution to practice one's profession. Therefore, a conjoint reading of Section 30 of the Advocates Act and Sections 8 and 9 of the Code together with the Adjudicatory Authority Rules and Forms thereunder would yield the result that a notice sent on behalf of an operational creditor by a lawyer would be in order."*

The closing statement by the Hon'ble Supreme Court, *"In as much as the two threshold bars to the applications filed under Section 9 have now been removed by us"* has granted a sigh of relief to the foreign operational creditors facing operational difficulties.

Conclusion:

The closing statement by the Hon'ble Supreme Court, *"In as much as the two threshold bars to the applications filed under Section 9 have now been removed by us"* has granted a sigh of relief to the foreign operational creditors facing operational difficulties. While the Code intended to shift the test of insolvency from 'inability to pay' to 'failure to pay', before concluding the position on operational grounds it becomes very important to look at the purpose or object of the statute. In order to keep the spirit of the law intact, it becomes necessary to interpret the provisions keeping in mind the Parliament's language and the object that Parliament had in mind. ■

[7] https://indiankanoon.org/doc/1868823/