Evolution of Insolvency and Bankruptcy Code, 2016 based on Judicial Interpretation and Pronouncement

The purpose of this article is to find how the Insolvency and Bankruptcy Code, 2016 has evolved through judicial interpretation and pronouncement in the last one year after its initiation. It is being understood that higher judiciary is supportive of the spirit of Insolvency and Bankruptcy Code, 2016, particularly the concept of "creditors in possession", and are generally not intervening in the process. Insolvency proceeding under the code cannot be stayed or delayed by the debtors on flimsy grounds as the trend in the judgements is showing. The emphasis on need of speedy resolution is being felt at NCLT as well as the higher level of judiciary. At the same time, the higher courts will not stop from intervening in rare cases in the interest of justice and equity in public interest litigation (PIL) for example. Higher judiciary may also encourage compromise and withdrawal of insolvency proceedings in deserving, genuine and simple situations, by use of its exceptional power under Article 142 of the Constitution. The author has examined five cases here, three at the Supreme Court level and two at the High Court/NCLT level to come to such conclusion about these trends. Read on to know more….

Since we are a common law country, all our laws are eventually tested with the touchstone of the higher judicial systems of India, namely the High Courts and Supreme Court of India, so that further interpretations are available, and gap and/or ambiguity, if any, in the written law is filled up and the law gets a stable foundation of precedence. Apart from this, the law has also to pass the test of equity and justice on the one hand and non-violation of the fundamental rights of its citizens guaranteed by the constitution on the other. In a very rare and sensitive situation, the court has also to find whether the law is against the basic structure of the constitution.

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About a year ago

The Insolvency and Bankruptcy Code, 2016 (No. 31 of 2016) ("the Code" for short) came into effect with the assent of the President of India on 28th May 2016. In a notification dated 1st June, 2016, the Central Government had constituted 11 benches of the National Company Law Tribunal (NCLT) in different states. Under Part II, Chapter VI of the Code, National Company Law Tribunal (NCLT) would be adjudicating authority for insolvency resolution and liquidation of Companies, Limited Liability Partnerships (LLPs), any entity with limited liability under any law and bankruptcy of personal guarantors thereof. In exercise of the powers conferred by sub-Section (1) and (3) of Section 188 of the Code, the Central Government established

the Insolvency and Bankruptcy Board of India on 1st October, 2016 which has regulatory oversight over the Insolvency Professionals, Insolvency Professional Agencies and Information Utilities needed for operation of the Code. It also writes and enforces rules for transactions, namely, corporate insolvency resolution, corporate liquidation, individual insolvency resolution and individual bankruptcy under the Code.

Thus about a year has passed by now, as the framework of the new code came into operation.

The uniqueness of the Code

The Code is unique in many ways, in that it has for the first time replaced a "debtors in possession" system with a "creditors in possession" system and it resolved many overlapping jurisdictions in many laws and amended or repealed some of the laws to provide for a uniform and fast insolvency and bankruptcy resolution process in India. It modeled itself around the UK laws, rather than US laws in this matter and also introduced for the first time insolvency professionals into the resolution of insolvency.

Purpose and approach of this article

The purpose of this article is to find how the Code has passed through the judicial tests, and in which direction it is evolving over the last one year. The approach here is to examine, case by case, and find the direction.

As of date, the higher judiciary has not found any section of the Code against the fundamental rights of the citizens of India or against the basic framework of the constitution. But there has been several judicial interpretations and pronouncements and one major intervention by higher judiciary, which we shall discuss in the following paragraphs.

Innoventive Industries Limited vs. ICICI Bank and another[1]

The judgement of the Supreme Court of India in one place says *"According to us, once an insolvency professional is appointed to manage the company, the erstwhile directors who are no longer in management, obviously cannot maintain an appeal on behalf of the company."* This is a clear example of recognition of the principle of "creditors in possession" structured by the Code as against "debtors in possession" that was prevailing earlier. That the Supreme Court has not found any violation of rights of the debtors, for creditors to be in charge of his assets, at an intermediate stage of insolvency resolution, is a very welcome situation. Being burdened with more than eight lac crore of rupees of bad and doubtful debts, our banks probably needed this encouragement. In another place the judgement says *"the object of this Code is that the interests of all stakeholders, namely shareholders, creditors and workmen, are to be balanced and the old notion of a sick management which cannot pay its financial debts continuing nevertheless in the management seat has been debunked by the Code."*

The Code is unique in many ways, in that it has for the first time replaced a "debtors in possession" system with a "creditors in possession" system and it resolved many overlapping jurisdictions in many laws and amended or repealed some of the laws to provide for a uniform and fast insolvency and bankruptcy resolution process in India.

Since this was the first application under the Code, the Court chose to elaborate some more points as part of this judgement for future reference. May be the court through this will reduce multiplicity of litigation. The court liberally quoted from the report of the Bankruptcy Law Reforms Committee, 2015, the most important paragraph it quoted is *"The limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say."* The court noted that the Code is modeled around UK law which advances the cause of "creditors in possession" *vis-à-vis* "debtors in possession" under the US Law, and had no qualms in accepting the UK principle, while both are common law countries.

While many acts and laws were modified and/or repealed to make way for the Code one act that was not repealed is "The Relief Undertaking Act"(RUA) passed by various states to protect the so called interest of workers when an undertaking was about to close down. The appellant in this case, tried to roll back the entire process under the Code by taking shelter under the RUA since it is already declared a "relief undertaking" and is subject to RUA, in this case Maharashtra RUA.

The court opined *"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. Further, the non-obstante clause contained in Section 4 of the Maharashtra Act cannot possibly be held to apply to the Central enactment, in as much as a matter of constitutional law, the later Central enactment being repugnant to the earlier State enactment by virtue of Article 254 (1), would operate to render the Maharashtra Act void vis-à-vis action taken under the later Central enactment."

Also, the court took notice of the overriding principle of the Code over other laws contained in the following section of the code, which reads as follows:

"Section 238- The provisions of this 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."

Thus, it is now well settled that companies who were declared 'relief undertakings' under any RUA of any state of India have no protection against the Code being applied to them. The creditors have a right to take them to NCLT in case they have dues from the Company irrespective any status or circumstance prevailing under RUA.

Essar Steel Ltd. vs. Reserve Bank of India[2]

RBI had directed the commercial banks to file petition under the Code to NCLT against some specific companies on priority basis. Essar Steel being one of them had moved the Gujarat High Court against the RBI order with a special civil application. The grounds taken by Essar Steel as evident from an interim order of the judge are as follows:

"Company is trying to restructure the package approved by the Board of Directors, but before any concrete decision has been arrived at between the parties, all of a sudden a Notification in the form of Press Release dated 13.06.2017 by the Reserve Bank of India has come in picture. Irrespective of other averments and directions in such press release, one line is quite shocking which reads thus; 'Such cases will be accorded priority by the National Company Law Tribunal (NCLT).'

2. It seems that by such direction, the Reserve Bank of India has classified few companies whose accounts are disclosed as Non-Performing Assets. However, for taking action against such companies, the effective date is considered as 31.03.2016 though press release is dated 13.06.2017 and, therefore, it is submitted that if at all the Reserve Bank of India has power to classify such company, then also, classification has been made vide this notification based upon the details as on 31.03.2016 and not as on 31.03.2017.

3. It is also submitted that petitioner company has paid almost ₹3467/- Crores in last one year and as many as 4500 employees are working with the company and company is doing well since last one year and would be revived in view of serious effort of revival of the company by the company and the bank also by settling the accounts suitably.

4. Therefore, petitioner is apprehending that if action is taken as per press release dated 13.06.2017, then considering the provisions of Section 7, 16 and 17 of the Insolvency and Bankruptcy Code (IBC), 2016 the administration of the company would go into hands of Interim Resolution Professional and it would result into closing of petitioner company which is almost in the stage of revival and when it is in the position to pay ₹3467/- Crores to the bank in last year."

It is very clear that this application was on a few technical grounds. And once again, as in a RUA case, the so called workers' interest has been used as a shield in the argument. It raised a question whether RBI can tell that such cases will be accorded priority by NCLT, when NCLT is a quasi-judicial or judicial authority and RBI has no administrative authority or control on NCLT. The other technical ground was whether non-performing assets calculated on an earlier date, be considered as the basis for starting a process of application under the Code before NCLT. The third point was when company is in the process of so called "revival" or "restructuring" whether an insolvency process under the code can be started against the Company on a selective basis at the instruction of RBI.

The High Court gave no relief to Essar Steel in the final order, except for mildly admonishing RBI.

Thus it is now well settled that companies who were declared 'relief undertakings' under any RUA of any state of India have no protection against the Code being applied to them. The creditors have a right to take them to NCLT in case they have dues from the Company irrespective any status or circumstance prevailing under RUA.

Thereafter by an order dated August 2, 2017, Ahmedabad Bench of the NCLT admitted the insolvency petition filed by SBI and Standard Chartered Bank against Essar Steel and appointed an Interim Insolvency Resolution Professional and gave a few other consequential directions.[3]

In one place the Tribunal made the following observation:
"From the material placed on record, it is in the year 2014 that Debt Reconstructing Process commenced. For one reason or the other, the Debt Reconstructing Process has not been finalised till today or till the date of filing of the Applications. It is not a case where ESSAR owed monies to Lenders in the previous year. The Lenders are there from the beginning of the ESSAR Company. As contended by the learned Senior Counsel for ESSAR there are several reasons that prevented the ESSAR from discharging the debts. No doubt, there are no allegations of siphoning of funds, diversion of funds or fraud. But, the fact remains that except showing a little progress in the last financial year, there appears to be no scope for the ESSAR to repay its debts till 25 years or in a span of 25 years."

It may be noted that proving of fraud or siphoning of funds are very difficult, in a corporate scenario, and there have been very few successful prosecutions in this area. If the creditors have to wait for proving diversion of funds or fraud, to enforce their rights in the Code, very few cases under the Code will survive.

As the above story shows, a petition filed by a financial creditor to NCLT for initiating the process of insolvency resolution cannot be resisted on flimsy grounds and higher courts have been extremely reluctant to issue any order for stay once a process has been started at the NCLT under the code.

Subsequent to this on August 14, 2017, there was another development in the Supreme Court when it took notice of the fact that the insolvency process in respect of Essar Steel has started and interim insolvency resolution professional has been appointed, and therefore, restrained Essar Steel from taking any action on acquisition of certain forest lands, apprehending it will not be able to pay the cost of development.[3A]

While the above two cases demonstrate the supportive interpretation of law by the higher judiciary, which eventually put implementation of the Code on strong foundation, the Supreme Court has not hesitated to make an intervention where it felt necessary as the following case shows.

A petition filed by a financial creditor to NCLT for initiating the process of insolvency resolution cannot be resisted on flimsy grounds and higher courts have been extremely reluctant to issue any order for stay once a process has been started at the NCLT under the code.

The case of *Jaypee Infratech*[4]

On August 9, 2017, the National Company Law Tribunal (NCLT) had admitted the petition of IDBI Bank initiating the insolvency resolution process of Jaypee Infratech for default of large loans. It had also appointed the Interim Insolvency Resolution Professional which superseded the Board of Directors of the Company.

As per the provisions of insolvency code, the financial interest of the secured creditors take precedence over that of unsecured creditors. Homebuyers, who booked apartments with Jaypee Infratech and paid advances, are under the law in the category of unsecured creditors and after the order of NCLT they were left high and dry, as there was no certainty that the homebuyers will get the possession of their apartments or refund of the money they paid as advance.

The aggrieved homebuyers then filed a public interest litigation (PIL) seeking a stay order on NCLT insolvency proceedings against Jaypee Infratech because during the insolvency proceedings all the claims in any other court, all orders of compensation against the company was to be dealt by NCLT. Any recovery proceeding was also to be suspended or transferred to NCLT.

The home buyers, who are technically unsecured creditors stood very little in chance to get their money after the secured creditors like IDBI Bank are paid, while they had already filed civil or consumer court cases against Jaypee Infratech for getting possession of the promised apartments as well as loss of interest and cost of stay in rented apartments because of delay in delivery of the apartments.

The Supreme Court intervened in the matter on 4th September, 2017, restored the superseded board of directors of Jaypee Infratech and directed that all the proceedings against the Company/its Directors in the consumer court and civil courts can continue.

Clearly it felt that under the veil of NCLT proceedings, the Directors and the Company are being let off the hook. This is an interim decision.

However, on a representation by IDBI Bank on 11th September, 2017, the Supreme Court of India stated that the Insolvency Resolution Professional (IPR) shall forthwith take over the management of JP Infratech Limited (JIL). Also it said that Jayprakash Associates Limited (JAL) which is the parent company of JIL, must deposit ₹2000 crores to the court before 27.10.2017, and the Directors of JIL and JAL should not leave India. In the meantime, all the other cases shall remain stayed.

Thus the court had lifted the corporate veil and extended the case to the Directors and the parent company.

Lokhandwala Kataria Construction Private Limited vs. Nisus Finance and Investment Managers LLP[5]

The Supreme Court in this case ruled that a settlement can be considered and a case can be withdrawn even after insolvency proceedings have started against a company on the merit of the case. The Mumbai bench of the National Company Law Tribunal (NCLT) on 15th June, 2017 initiated a corporate insolvency resolution process against the debtor. Later, the debtor company and the creditor approached the National Company Law Appellate Tribunal (NCLAT) saying that the two had settled the dispute amicably and that some of the dues had already been paid, so the proceedings may be dropped. NCLAT said on 13th July, 2017 that under the Code, a case can be withdrawn before the admission of an insolvency petition, and not after that. The parties then filed an application with the Supreme Court, with the same pleading, which allowed a settlement to be considered under Article 142 of the Indian constitution. However, since this is a judgment under Article 142, it will not act as a precedence, and the court also clarified this and stated that NCLTs do not appear to have the inherent power to drop an insolvency proceeding under the Code once it is initiated.

Higher judiciary may encourage compromise and withdrawal of insolvency proceedings in deserving, genuine and simple situations, by use of its exceptional power under Article 142 of the Constitution.

Although this case will not set any judicial precedence, the higher judiciary has shown the maturity that is deserved of it, and has shown availability of a very narrow window, which can be used in genuine cases, to resolve simple insolvency matters, even after initiation of the proceedings at NCLT, on a mutual consent and case to case basis. The only requirement in such case is perhaps there should not be too many creditors with conflicting and multiple claims.

Conclusion

It is being understood that higher judiciary is supportive of the spirit of Insolvency and Bankruptcy Code, 2016, particularly the concept of "creditors in possession", and are generally not intervening in the process. Insolvency proceeding under the code cannot be stayed or delayed by the debtors on flimsy grounds as the trend in the judgments is showing. The emphasis on need of speedy resolution is being felt at NCLT as well as the higher level of judiciary. At the same time, the higher courts will not stop from intervening in rare cases in the interest of justice in a public interest litigation (PIL) for example. Higher judiciary may also encourage compromise and withdrawal of insolvency proceedings in deserving, genuine and simple situations, by use of its exceptional power under Article 142 of the Constitution. ■

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