

5th Colloquium for Hon'ble Members of NCLT

Respected Mr. Justice MM Kumar, President of the NCLT; Mr. Justice R.P Nagrath, Member of the NCLT; Mr. Injeti Srinivas, Secretary of Ministry of Corporate Affairs; Dr. M S Sahoo, Chairman IBBI; and other distinguished guests. It gives me great pleasure to deliver the inaugural address at this 5th Colloquium for the Hon'ble Members of the NCLT.

On our country attaining independence, as a society we carried a baggage of the evil "money lender." The economic activity in the country evolved over a period of time, but the mindset against the person lending the money remained. This was reinforced by the social literature as well as the cinema. In a way this was reflected in the soft approach adopted to recover dues, even for commercial activity, even though the original mindset originated from the relationship of the traditional money lender and a farmer. The result was a slowing down of economic activities on account of non-recovery of dues and it became a nightmare for lending institutions to recover their legitimate dues. The money which got stuck in this process, thus, were not capable of further circulation for expanding economic activity.

On a personal note, from 1990s I was associated with the Indian Chapter of the INSOL International and have had the benefit of attending its various judicial colloquiums. We kept on assuring the international fora that the country was moving towards an international regime, but after a stage it was difficult to answer as to how long it would take for a fast-growing country like ours to bring a regime in conformity with international practices. It was only the new regime of the Insolvency and Bankruptcy Code, 2016 which answered these questions.

The NCLT, a child of this regime, thus came about as an expert body having both legal and technical expertise in the concerned commercial law areas, to bring about an expeditious and practical resolution of such disputes. I am glad that events as are being organized today are being held as they help in exchange of ideas and allow for brain-storming which strengthens the framework of law as well as the economic health of the nation.

The endeavor of the Supreme Court was to, as early as possible, settle the broad controversies so that unnecessary litigation was not generated at different level. Settlement of the legal position is one of the most important functions of the highest court, more so in respect of new legislations, so that they are not bogged down in repeated challenges, in multifarious proceedings.

It is not my endeavour to go into a piece by piece analysis of the provisions of the Code as all of you are well versed in it and operate it on a day-to-day basis. My endeavour is to put forth the expositions of the legal effect of these provisions, in view of the judicial pronouncements of the Supreme Court.

Before proceeding to the examination of the judicial precedents of the Supreme Court, it would be appropriate to take notice of the judgment of the Calcutta High Court in *Akshay Jhunjhunwala & Anr. v. Union of India* where the provisions of Sections 7 to 9 of the Code came up for consideration. The constitutional validity of the Code was upheld and the challenge repelled. Since these aspects dealt with certain functional aspects, let me summarize the conclusion as under:

- The classification made by the IBC between financial creditors and operational creditors is based on reasonable differentia and does not offend any provision of the Constitution of India.
- The rationale provided for the difference in treatment between financial creditors and operational creditors is a plausible view taken for an expeditious resolution of an insolvency issue of a company and cannot be said to offend any provisions of the Constitution of India.

Now proceeding to the judgments of the Supreme Court, let me turn to the two pioneering efforts to which I was fortunate to be a participant, as a Judge:

Innoventive Industries Ltd. v ICICI Bank & Anr :

In this case, the following issues were deliberated upon, by us:

- i) The concept of default under the Insolvency Code and how it must be ascertained;
- (ii) The scope and extent of enquiry at the admission of an insolvency application;
- (iii) The scope of hearing to be provided to a corporate debtor; and
- (iv) The conflict between an existing state act (Maharashtra Relief Undertaking Act (MRU Act)) and the Insolvency Code

Since judicial examination of the Code was at its nascent stage, we endeavoured to examine the Code and observe the dovetailing effects of its various provisions in detail. We highlighted the importance of removing entrenched managements of various defaulting corporate debtors in cases of non-payment of debts.

- The examination of the Code, most importantly needed a clear understanding of 'default', which is a focal point for the triggering of the Code. The scope of 'default' under the Insolvency Code is very wide. It is simpliciter a non-payment of debt when the same becomes due and includes non-payment of even a part thereof.
- However, a difference in the understanding of 'default' is maintained between the different classes of creditors. We noticed this difference in the scheme right from the point of initiation of insolvency proceedings.

- The scope of enquiry before the adjudicating authority is limited to assessing the records provided by the financial creditor to satisfy itself that the default has occurred. The adjudicating authority may therefore only reject an application on a defence taken by the corporate debtor that the debt was not due and not otherwise.
- The adjudicating authority is to be merely satisfied that a default has occurred while 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. The moment the adjudicating authority is satisfied that a default has occurred, the application must be admitted unless it is incomplete, in which case the appropriate authority may give notice to the applicant to rectify the defect within 7 days of receipt of a notice from the adjudicating authority.
- We also held that between a State Law and the IBC, with respect to provisions dealing with insolvency and bankruptcy, it was the Code that would prevail, in cases of conflict.

Mobilox Innovations Private Ltd. v Kirusa Software Pvt Limited:

The issue before us in this case was primarily about the differing standards applicable to operational and financial creditors, under the Code.

- 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.
- In our decision, we recognized the basis for such a differentia between the two categories of creditors. These differences exist because operational debts tend to be of smaller amounts (in comparison to financial debts) or are recurring in nature and may not be accurately reflected on the records of information utilities at all times.
- The possibility of disputed debts in relation to operational creditors is also higher in comparison to financial creditors such as banks and financial institutions. Accordingly, the process for initiation of the insolvency resolution process differs for an operational creditor. Once a default has occurred, the operational creditor has to deliver a demand notice or a copy of an invoice demanding payment of the debt in default to the corporate debtor. The corporate debtor has a period of ten days from the receipt of the demand notice or invoice to inform the operational creditor of the existence of a dispute regarding the debt claim or of the repayment of the debt. This ensures that operational creditors, whose debt claims are usually smaller, are not able to put the corporate debtor into the insolvency resolution process prematurely or initiate the process for extraneous considerations.

- A financial creditor, on the other hand need submit only a record of default by the entity, as recorded in a registered Information Utility, directly to the Adjudicating Authority. The default can be to any financial creditor to the entity, and not restricted to the creditor who triggers the IRP. Operational creditors must, ultimately present, to the Adjudicatory Authority, an "undisputed bill" which may be filed at a registered information utility as requirement to trigger the IRP. In case the financial creditor triggers the IRP, the Adjudicator verifies the default from the information utility or otherwise confirms the existence of default through the additional evidence adduced by the financial creditor, and puts forward the proposal for the RP to the Regulator for validation. In case the operational creditor triggers the IRP, the Adjudicator verifies the documentation.

One of the aspects which troubled the Supreme Court was that even where parties compromise the dispute, there was no mechanism to allow such a compromise, resulting in the Supreme Court being compelled to use its powers under Article 142 of the Constitution of India. In *Uttara Foods & Feeds Private Limited v. Mona Pharmachem*, by the order dated 13th November, 2017, the Supreme Court made a recommendation for the relevant Rules to be amended by the competent authority to include such inherent powers to compromise the matters. I am glad that this has resulted in the necessary amendments to the Code by introduction of Section 12A in the 2018 Amendment Ordinance, apart from other aspects of the Amendment Ordinance arising from experience of operating the Act. These amendments came into effect on 6th June, 2018.

Some of the key changes are as follows:

1. Homebuyers – A New Class of ‘Financial Creditors’:

The declining price of real estate changed the dynamics of investment in the sector. It is trite to say that a lot of investment was made in the real estate sector with the object of encashing the profits. However, instead of that, the declining prices created an excess capacity. Not only had builders used moneys collected for ‘A’ project for buying land for ‘B’ project in a reverse pyramidal structure, the collapse of the same resulted in projects not being completed and a glut in the market. There were grave apprehensions of the investors who had invested their hard earned money to buy a home, even by borrowing from banks and financial institutions. On an endeavour by the creditors to enforce the provisions of the Code, these homebuyers saw their dreams collapse and wanted a say in the process. The Supreme Court came to the aid of such flat buyers.

The need for making necessary changes in the Code were, thus, felt and this is one aspect dealt with in the Ordinance. The 2018 Ordinance has amended the definition of ‘financial debt’ to include amounts raised from ‘allottees’ in respect of a real estate project (as defined under the Real Estate (Regulations and Development) Act, 2016 (RERA)). Accordingly, homebuyers will now be entitled to a seat on the ‘committee of creditors’ (CoC) of the corporate debtor. However, given the large number of homebuyers for a project, they will be treated as a class of creditors and be represented in the CoC by an ‘authorised representative’ to be appointed by the National Company Law Tribunal (NCLT).

2. Lowering of CoC Voting Thresholds:

Previously, all decisions of the CoC needed to be approved by 75% of the voting share of the CoC members. This threshold has now been lowered to 51% except for the following requirements:

- 90% approval for withdrawal of an insolvency application post admission by the NCLT (*dealt with in more detail below*).
- 66% approval for resolutions: (i) approving extension of the corporate insolvency process beyond 180 days; (ii) relating to matters listed out under Section 28 of the IBC; (iii) approving a resolution plan; and (iv) replacing a resolution professional.

3. Post Admission Withdrawal:

The 2018 Ordinance has introduced Section 12A permitting the NCLT to now allow insolvency proceedings to be withdrawn provided it has the consent of 90% of the voting share of the CoC members.

4. Moratorium Not to Apply to Guarantors:

The 2018 Ordinance has clarified that the moratorium imposed by the NCLT under Section 14(1) (at the time of admission of an insolvency application) will not apply to guarantee contracts in relation to the corporate debtor's debt.

Additionally, Section 61(3) of the IBC has been amended to ensure that the NCLT (which has jurisdiction over the insolvency resolution of the corporate debtor) will also have jurisdiction over the insolvency resolution of the corporate guarantor (irrespective of the jurisdiction (within India) where the corporate guarantor may have been incorporated in). This provision previously only covered personal guarantors.

5. Restrictions w/s 29A:

Before 29A, every individual or body corporate could participate in a bidding process of a Corporate Debtor which is subject to the Corporate Insolvency Resolution Process irrespective he is the original promoter, director or person connected to them directly or indirectly. So, persons who, by their misconduct or fraudulent motives, contributed to the default of the Corporate Debtor, could regain control of their company again by bidding in hefty discounts.

Section 29A was introduced to disqualify only those, who had contributed in the downfall of the corporate debtor or were unsuitable to run the company because of their antecedents whether directly or indirectly.

Section 29A as introduced by the IBC Amendment Act, inter alia provides that a person shall not be eligible to submit a resolution plan, if such person is a *connected person not eligible under clauses (a) to (i)* as set out therein. A '*connected person*' is a person who is:

- (a) A promoter or in the management or control of the resolution applicant;
- (b) A 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;
- (c) A holding company, subsidiary company, associate company or related party of a promoter or a proposed promoter during the implementation of the resolution plan.

The object and intent to introduce Section 29A was to keep the bidders list clean and to avoid a risk of a repeat of the situation.

Conclusion

The exposition of law in this field is evolving. We are in the process of learning and speeding up the processes so that proceedings can come to an end quickly and efficiently with the best deal for all as may be possible. Prolongation over years was no answer. The inevitable had to take place. Let me say that the NCLT and the NCLAT has been playing a salutary role in this and I have not the slightest doubt that we will evolve the mechanism as we go on, into an efficient methodology of dealing with such corporate bankruptcies. All of you have the fortune of being initial implementers and, thus, creators of the law. I wish you all good luck in this endeavor.