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CORPORATE INSOLVENCY: ITS OPERATIONS AND EMERGING PROBLEMS

—Navin K. Pahwa*

"*Economic growth must be the central issue because it is only through growth that the devastating threat of national bankruptcy can be averted.*"

—Robert Zubrin

Abstract The paper seeks to highlight the challenges emerging in the application and implementation of the Insolvency and Bankruptcy Code, 2016. The Code is undoubtedly a very historic reform in the Indian economic sector and has already witnessed amendments as well as judicial interpretations. In this paper, the author highlights some operational problems that are emerging as this Code is being implemented, such as the liability of guarantors, the eligibility of promoters, limitation period, going concern concept, etc. Although the Code is facing such challenges, the author is of the view that with correct judicial and legislative interference, it may grow into a mature and effective piece of legislation, and improve the ease of doing business as well as the economic scenario in India.

I. INTRODUCTION

Insolvency can also be termed as the procedure of financial death and rebirth. Keeping this in mind, Elizabeth Warren called America as a nation of debtors. Well, I cannot vouch for America, but India, since a long time now, is on the brink of snatching away this feat from America. India, especially in the recent past, can be very much called as a nation of hostile debtors.

* Senior Advocate, High Court of Gujarat, Ahmedabad.

The Legislature in 2016 identified the issue and came to the conclusion that the existing set of laws and forums has not been able to aid various lenders in efficacious recovery/restructuring of debts. This also has the serious effect of causing undue stress upon the existing Financial and Credit System of the country. Reforms and the implementation thereof are critical and urgent attention was found necessary to alleviate the business environment. The Indian Legislature has been contemplating these reforms since 1964. The Law Commission and various committees constituted by the Parliament and the Reserve Bank of India including the Tiwari Committee, Narsimhan Committee, L.N. Mitra Committee, Raghuram Rajan Committee, Bankruptcy Law Reforms Committee and finally, the Joint Parliamentary Committee brought about the present Insolvency and Bankruptcy ('IB') Code.

The object of the Code is to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues. The Code also seeks to establish an Insolvency and Bankruptcy Board of India ('IBBI').

This enactment is historical in the sector of economic reforms in India. The enactment is being made meaningful with recent judicial pronouncements by the National Company Law Tribunal ('NCLT'), National Company Law Appellate Tribunal ('NCLAT') and the Hon'ble Supreme Court of India. The law in this area is growing day by day. It is becoming purposive and useful with judicial interpretations and legislative amendments. The committee set up by the Government of India is constantly suggesting further changes to this regime. The enactment, though considered to be draconian by certain jurists and economists, cannot be disputed to be revolutionary.

II. OPERATIONAL & IMPLEMENTATION CHALLENGES OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

A. Dispute vis-à-vis operational debt: Saga of Spurious Litigation and "Pre-Existing" Disputes

Sec. 8(2)(a)[1] of the IB Code stipulates that upon receipt of demand notice of unpaid operational debt, the Corporate Debtor shall, within a period of ten days

[1] Insolvency and Bankruptcy Code § 8 reads as, "Insolvency resolution by operational creditor (2). The corporate debtor shall, within a period of ten days of the receipt of the demand notice or copy of the invoice mentioned in sub-section (1) bring to the notice of the operational creditor— (a) existence of a dispute, if any, and record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute;".

thereof bring to the notice of the Operational Creditor existence of a dispute, if any, and record of pendency of the suit or arbitration proceedings filed before the receipt of such notice. Sec. 9(5)(ii)(d)[2] of the IB Code stipulates that if notice of dispute is received by the Operational Creditor or there is a record of dispute in the information utility, the application under the IB Code is liable to be rejected by the NCLT. The operation of both these provisions is essentially dependent and embedded in the word "dispute".

After various pronouncements by different NCLTs and the NCLAT on the ambit of the word "dispute" and/or "pre-existing dispute", the Hon'ble Supreme Court in *Mobilox Innovations (P) Ltd.* v. *Kirusa Software (P) Ltd.*[3] has brought rest to the controversy. The Hon'ble Supreme Court held and observed that in the event a notice of dispute has been received by the Operational Creditor, bringing on record existence of a dispute or the fact that a suit or arbitration proceeding relating to a dispute is pending between the parties, the application of the Operational Creditor is liable to be rejected.

The word "and" used in Sec. 8(2)(a) shall have to be read as "or" meaning thereby "existence of a dispute" or "pendency of suit or arbitral proceedings" is sufficient to reject an IB Application. It is also held that the Adjudicating Authority is to see whether there is a plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence. A *spurious defence* is liable to be rejected. The merits of the defence are not required to be examined except to the extent above stated. So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the Adjudicating Authority has to reject the application.

The challenge which remains to be addressed is filing of frivolous suits or initiation of arbitration proceedings by the Corporate Debtors with a view to pre-empting IB action. There is, thus, a need to either bring about appropriate amendments or the Hon'ble Supreme Court may make an appropriate and harmonious construction of the provisions contained in Sec. 8(2)(a) and may also consider permitting the NCLT to dwell on merits of the "pre-existing dispute" and the merits of the claims of the suit and/or arbitral proceedings.

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[2] Insolvency and Bankruptcy Code § 9 reads as, "Application for initiation of corporate insolvency resolution process by operational creditor (5). The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), by an order (ii) reject the application and communicate such decision to the operational creditor and the corporate debtor, if (d) notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility;".

[3] (2018) 1 SCC 353.

B. Limitation

Sec. 3 of the Limitation Act, 1963 puts a bar on every suit or proceedings filed beyond the limitation period. Art. 137 of this Act, which is a residuary article, stipulates a period of three years. The IB Code does not stipulate that the Limitation Act does not apply to it. It also does not expressly exclude the application of the Limitation Act. Sec. 245 to Sec. 255 of the IB Code, by which various enactments are amended to avoid conflict, do not provide for any amendment to the Limitation Act.

A bare perusal of Sec. 29 of the Limitation Act, read with the ratio laid down by Hon'ble Supreme Court in various judgments, would make it clear that whenever and wherever a special or local law does not expressly exclude the application of the Limitation Act, the provisions contained in Sec. 4 to Sec. 24 (inclusive) shall apply to proceedings under any special or local law. If this is not done, then there could be a scenario where creditors may reopen long forgotten closed accounts. It may result into multiplicity of proceedings. It may also have a *dominos effect* which may become a menace for the Indian economy.

The NCLT, Mumbai Bench in *Urban Infrastructure Trustee Ltd.* v. *Neelkanth Township and Construction (P) Ltd.*[4] rejected the contention on applicability of law of limitation to the IB Code. The NCLAT confirmed the judgment.[5] The Hon'ble Supreme Court, in the challenge, while confirming the view of NCLT/ NCLAT on merits, however, kept the issue of limitation open.

The NCLT, Delhi Bench, however, has taken a contrary view. It has held that the Limitation Act would apply to the IB Code.[6] The NCLAT reversed this judgment and held that the Limitation Act would not apply. The case is remanded to NCLT to decide it on merits.[7] The Hon'ble Supreme Court, in the challenge made, has issued notice and in the meanwhile, granted stay against the order of remand. The issue of limitation is, thus, *sub judice.*

C. Resolution Plan and the Concept of Going Concern

Sec. 5(26) of the IB Code defines "Resolution Plan" to mean a plan proposed by any person for insolvency resolution of the Corporate Debtor as "a going concern" in accordance with Part-II of the IB Code. Part-II contains provisions for Corporate Insolvency Resolution Process ('CIRP'). The emphasis is on the Insolvency Resolution of the Corporate Person as a "going concern".

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4 2017 SCC OnLine NCLT 1531.

5 Neelkanth Township and Construction (P) Ltd. v. Urban Infrastructure Trustees Ltd., Company Appeal (AT) (Insolvency) No. 44 of 2017, Judgment dated August 11, 2017.

6 Parag Gupta v. B.K. Educational Services (P) Ltd., 2017 SCC OnLine NCLT 462.

7 Speculum Plast (P) Ltd. v. PTC Techno (P) Ltd., 2017 SCC OnLine NCLAT 319.

Sec. 20(1) of the IB Code specifically stipulates that the Interim Resolution Professional shall manage the operations of the Corporate Debtor as a "going concern". Sec. 25(2)(h) and Sec. 25(2)(i) of the IB Code stipulate an obligation on the Resolution Professional to invite prospective investors to put forward Resolution Plans and present the same before the Committee of Creditors. Sec. 29 stipulates preparation of information memorandum and Sec. 30 enables the Resolution Applicant to submit a Resolution Plan to the Resolution Professional. Sec. 31(3) contains an obligation on the Resolution Professional to present the Resolution Plan before the Committee of Creditors. Sec. 31(5) contains provisions with regard to the right of the Resolution Applicant to attend the meeting of Committee of Creditors in which the resolution plan is to be considered. Sec. 30(6), however, provides that the Resolution Plan approved by the Committee of Creditors be only placed before the Adjudicating Authority for approval.

Apparently, there is no provision under the IB Code providing for submitting a Resolution Plan rejected by the Committee of Creditors. Sec. 60(5)(c) of the IB Code, however, stipulates that the NCLT would have jurisdiction to entertain or dispose any question of priorities or question of law or facts arising out of or in relation to Insolvency Resolution of the Corporate Debtor. The NCLT, Ahmedabad Bench in *Vivek Vijay Gupta* v. *Steel Konnect (India) (P) Ltd.* came to the conclusion that reading Sec. 30(6) with Sec. 31 of the IB Code, it would have no jurisdiction to entertain a plea against rejection of a Resolution Plan by the Committee of Creditors, howsoever arbitrary or unreasonable the rejection may be.[8] This order is challenged before the Hon'ble High Court of Gujarat under Writ Jurisdiction and the same is pending for adjudication.[9] This view is also taken by NCLT, Mumbai Bench in *Gupta Coal India (P) Ltd., In re*.[10]

The Code particularly stipulates that the Adjudicating Authority would have jurisdiction over all the acts and omissions of the Resolution Professional and the Committee of Creditors. According to the Code, a resolution plan approved by the Committee of Creditors is required to be approved by the Adjudicating Authority. However, it is difficult to fathom that the rejection of the same by the Committee of Creditors is not required to be considered/approved by the Adjudicating Authority. This is the issue in crux which is pending before the Hon'ble High Court of Gujarat.

There is another anomaly which requires to be addressed urgently which pertains to the mandate of Sec. 33(2) of the IB Code. While reading the scope and purport of the scheme of the IB Code, it is apparent that the object of the IB Code is CIRP and not liquidation of the assets of Corporate Debtor. However, Sec. 33(2) gives arbitrary powers to the Committee of Creditors to take a decision to liquidate the Corporate Debtor at any time during the CIRP and intimate

[8] 2018 SCC OnLine NCLT 3902.
[9] SCA No. 1554 of 2018 before Hon'ble High Court of Gujarat.
[10] 2017 SCC OnLine NCLT 459.

the same to the Adjudicating Authority. The Adjudicating Authority is under a mandate to accept the decision of the Committee of Creditors and pass a liquidation order. This would imply that the Committee of Creditors may decide to dispense with the requirement of inviting Resolution Plans and may instead decide to liquidate the Corporate Debtor. This provision goes against the intent of the Legislature as reflected in the scheme of the Code. This provision is likely to cause serious injustice to the Corporate Debtor and its stake holders if the Committee of Creditors decides to be arbitrary. This challenge is required to be addressed on an urgent basis either by the Legislature or by the Judiciary.

D. Liability of the Guarantor

The issue as to whether the moratorium declared by the Adjudicating Authority under the IB Code would protect the guarantors has opened a debate. Sec. 2(e) as added by the Amendment Act, 2018 read with Sec. 60(1) and Sec. 60(2) of the IB Code would stipulate CIRP action both in relation to the Corporate Debtor and the personal guarantor.

The NCLAT in its recent judgment in *SBI* v. *V. Ramakrishnan* ('SBI') held that the moratorium will apply both to the property of the Corporate Debtor and the personal guarantor.[11] This ratio raises issues on deviation from well-settled concept of coextensive liability of the guarantor and the principal debtor as contemplated under Sec. 128 of the Contract Act, 1872. SBI is contemplating challenging this decision of the NCLAT.

The Committee constituted by the Government for the purpose of continuous review of the IB Code, apparently, is proposing to suggest amendments to the IB Code. It, however, appears that when the IB Code provides for protection in respect of the principle debtor, that is, the Corporate Debtor, it should also provide for protection of the properties of the personal guarantor during the moratorium period. The liability of the guarantor cannot be completely de-linked with the liability of the principal debtor.

E. Threshold Limit

Sec. 4 of the IB Code stipulates that for a default of Rs. One lakh or more, CIRP can be initiated. This amount is too small considering the impact of such proceedings. The consequences of admission of an IB application are serious. CIRP involves serious steps to be taken by all stakeholders. A small creditor may trigger insolvency action against a large Corporate Debtor.

The IB Code in such a situation may conflict with an existing Corporate Debt Restructuring ('CDR') or a sanctioned Scheme of Arrangement and the rights

[11] 2018 SCC OnLine NCLAT 384.

of stakeholders governed by such existing arrangements. This issue is a serious challenge which needs to be addressed as early as possible.

F. No say of Equity Shareholders

The essence of the IB Code is to revive a company as a going concern and not to liquidate it. The equity shareholders are the real owners of the Corporate Debtor. They have stakes in the corporate governance. The IB Code, however, is silent about their role.

The intent of the Legislature to exclude the interference of Executive and Judiciary is understandable to some extent, but to exclude the equity shareholders in matters of resolution of the Corporate Debtor requires a fresh consideration. The primacy given to the Committee of Creditors under the IB Code, without being diluted, may take into its compass consultation/concurrence of the equity shareholders of the company.

G. Ineligibility of Promoters

The Ordinance of 2017 and then, the Amendment Act, 2018 exclude the promoters of Corporate Debtors having Non-Performing Assets ('NPA') account for the defined period from submitting Resolution Plan. Sec. 29A of the IB Code now provides for a negative list of Resolution Applicants.

The amendment, though made to bring about transparency in the CIRP may, however, reduce the number of effective Resolution Plans. With the exclusion of the promoters, Resolution Plans may be submitted by the Resolution Applicants who may be only interested in acquiring the assets for commercial considerations. Resolution Plans being consistent with the concept of going concern may get sacrificed.

It is, therefore, desirable that a re-look be made to the amendment. The Resolution Plans by the promoters may, however, be subjected to stricter scrutiny by the Committee of Creditors and by the NCLT to avoid a repetition of *Synergies Castings*.

H. Settlement after the Admission Order: Can be considered only under Art. 142 of the Constitution of India

Rule 8 of the Insolvency and Bankruptcy (Adjudicating Authority) Rules, 2016 ('IB Rules') stipulates that the Adjudicating Authority may permit withdrawal of an Application made under Rules 4, 6 and 7 only before its admission. NCLT and NCLAT, therefore, refused withdrawal of the proceedings, even if parties have

settled the matter. Remedy in such cases is only under Art. 142 of the Indian Constitution before the Hon'ble Supreme Court.

The Hon'ble Supreme Court in *Uttara Foods and Feeds (P) Ltd.* v. *Mona Pharmachem*[12] allowed withdrawal of a petition under the IB Code after its admission in exercise of its jurisdiction under Art. 142 of the Indian Constitution. The Court also suggested an urgent need to amend Rule 8 of the IB Rules.

III. CONCLUSION

The IB Code, a conglomerate of various legislations, has brought sea changes in the concept of bankruptcy and insolvency. As the IB Code has brought sweeping changes, continuous indulgence of Judiciary and Legislature to interpret and/or suggest changes while addressing live issues may ultimately bring in place a mature and effective law which would not only improve the economy as a whole, but may also bring about ease of doing business in our country. The law is inspiring confidence amongst the creditors. However, it is also bringing about serious apprehensions in the minds of other stakeholders such as shareholders and small creditors, including in particular trade creditors. The big creditors such as the secured creditors are apparently under complete control of the CIRP. The primacy of the powers with the Committee of Creditors, which is controlled by major secured creditors, is resulting in decisions which are against the basic concept of "going concern". To avoid arbitrariness in the process of CIRP, a strong judicial control is must. The acts of arbitrariness including the acts of bias, unreasonableness, etc. can be checked by the judicial forum. Overall, the enactment is one of the most important and historical reform in this area of law in India. It has brought about changes which would not only support the economy but would also take it forward.

[12] (2018) 15 SCC 587.