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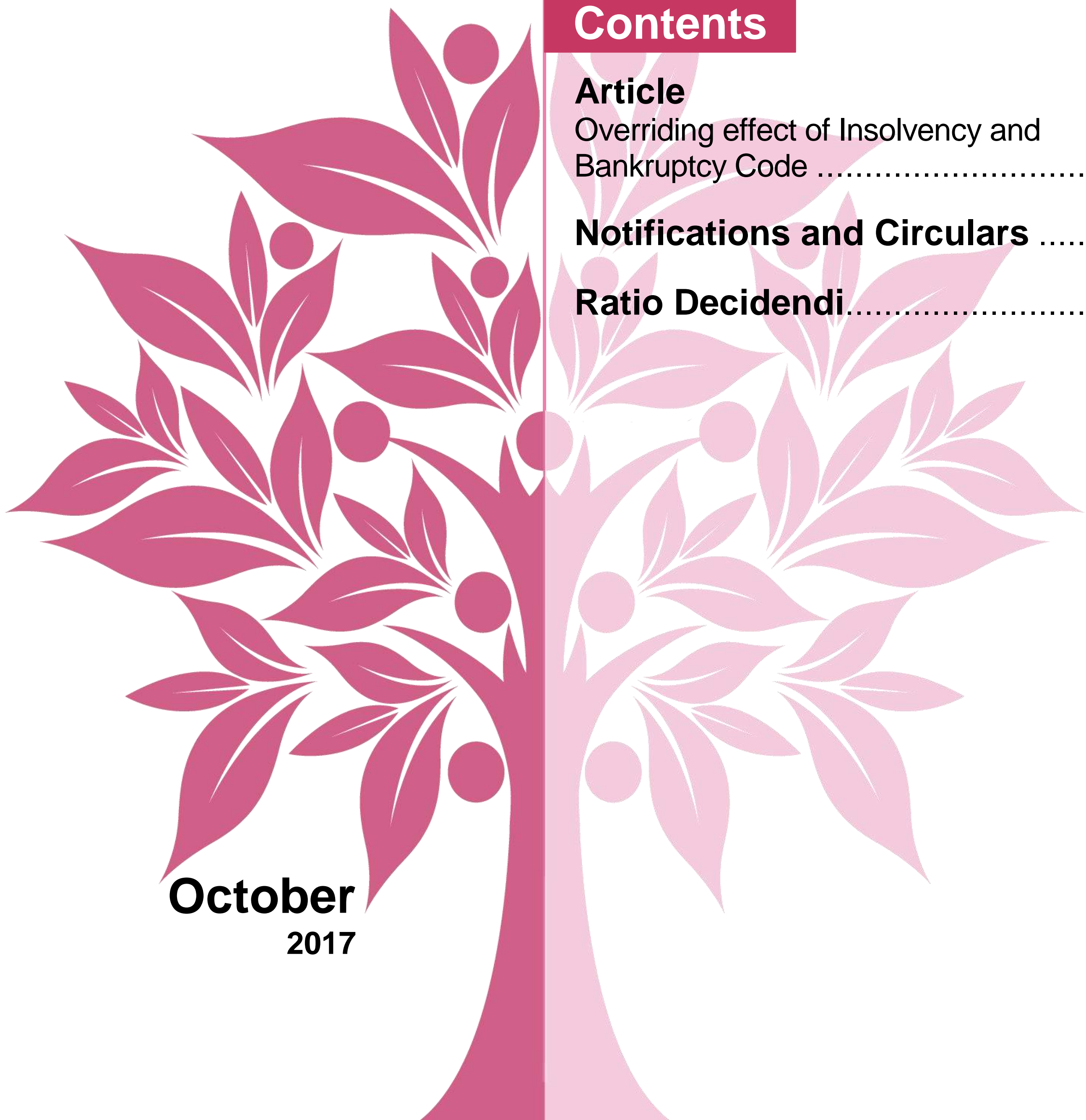

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October
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Article

Overriding effect of Insolvency and Bankruptcy Code

By **Aparajitha Narayanan**

Introduction:

Until the commencement of the Insolvency and Bankruptcy Code (hereinafter referred to as IBC) in May, 2016, there was no single legislation dealing with matters of insolvency and bankruptcy in India. It was widely known and accepted that a plethora of the erstwhile legislations apropos insolvency and bankruptcy were inadequate and could hardly cater to the needs of those who required quick resolution of their disputes since insolvency matters in India took 4.3 years on an average to be resolved, exponentially higher than the normal clearance ratio in other countries. The very objective of the IBC is, therefore, to warrant that all the insolvency and bankruptcy laws are brought under the same fortified roof of the IBC, and all disputes pertaining thereto are resolved swiftly and effectively.

Various judgments passed by National Company Law Tribunals (NCLT) and the National Company Law Appellate Tribunals (NCLAT) have made steady attempts to implement the law in letter and spirit. About 9 months post the commencement of the corporate insolvency resolution process (CIRP) provisions of IBC, the Hon'ble Apex Court has passed a judgment, for the first time, interpreting the scheme of IBC, along with certain key provisions, that goes on to establish the efficacy of IBC while upholding the reasons for which the said law was introduced.

Facts:

The Appellant (Innoventive Industries Limited), a multi-product company began to suffer losses, and was unable to repay financial assistance availed by it from 19 banks. Therefore, corporate debt restructuring was proposed by the Appellant and a Master Restructuring Agreement (MRA) was executed. Under the MRA, funds were to be infused by the creditors (banks), and certain obligations were to be met, in turn, by the Appellant. As things stood thus, the Respondent (ICICI Bank) made an application for initiating CIRP before NCLT, Mumbai.

The Appellant heavily relied on the Maharashtra Relief Undertakings (Special Provisions Act), 1958 (Maharashtra Act), which was enacted to provide financial assistance by the State Government, for certain industrial undertakings to prevent unemployment. It was contended by the Appellant that there was no debt legally due since as per the Maharashtra Act, for 2 years, all liabilities of the Appellant and remedies for enforcement thereof, were temporarily suspended, via declaration of moratorium, as a result of which, all proceedings relating thereto, pending before any Court, Tribunal, Officers or Authorities against the Appellant shall be stayed. The Appellant also contended that the non-obstante clause provided under the Maharashtra Act is to prevent unemployment in the industry, which prevails over the provisions of IBC, while the non-obstante clause mentioned in Section 238 of IBC[1] is to realise credit facilities availed by debtors, making it clear that the former is more of a worthy cause, which shall therefore not be

[1] The provisions of IBC 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.

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affected by the invocation of Section 238 of IBC. On the other hand, the Respondent contended that the Appellant had defaulted in making payments to it, there was an enforceable 'debt' owed by the Appellant which the MRA did not 'suspend'. Therefore, CIRP under IBC must be initiated against the Appellant. The Respondent also contended that under Section 7 of IBC, the adjudicating authority is required to determine whether 'default' has occurred or not, and accordingly admit an application under the said provision of IBC.

After two hearings before the NCLT, the Appellant moved an application and took a different plea to the effect that, since funds were not released as per the MRA, the Appellant was unable to satisfy payment of its debts, thereby no 'default' had actually been committed by it (earlier the Appellant had taken a plea that the Maharashtra Act overrides IBC).

NCLT Order: NCLT admitted the corporate insolvency petition against the Appellant concluding that the Appellant had indeed defaulted in making requisite payments to its creditors, consequently declaring a moratorium under Section 14 of IBC. NCLT also held that IBC shall prevail over the Maharashtra Act, since (i) the former is a parliamentary statute and (ii) the *non-obstante* clause mentioned in Section 238 of the IBC stipulates that IBC shall continue to operate even if its provisions are inconsistent with any other law in existence. NCLT also dismissed the subsequent application filed by the Appellant since it was filed belatedly and after completion of two hearings, wherein the Appellant had already been given an opportunity to be heard.

NCLAT Order: The Appellant then challenged the said order, before the NCLAT, which affirmed the NCLT order. However, it was held by NCLAT that although the Maharashtra Act is not repugnant to IBC, since the Maharashtra Act and the IBC operate in two completely dissimilar fields, the Appellant is not entitled to derive any advantage under the Maharashtra Act in order to delay insolvency proceedings under IBC. Furthermore, in relation to the MRA, it was held that the Appellant had 'defaulted' in paying its debts due to the financial creditor, therefore, the MRA could not be used to stave off initiation of CIRP.

Dissatisfied with the NCLAT order, the Appellant approached the Hon'ble Supreme Court.

Decision:

Paradigm shift in law: The Hon'ble Apex Court discussed the provisions of IBC at length, including the scheme and the objective of IBC, contrasting it against the insolvency and bankruptcy laws of other countries like USA, UK etc., and held that there is now a paradigm shift in insolvency law in light of IBC, since entrenched management is no longer allowed to manage a corporate debtor if it cannot pay its debts.

Repugnancy: The Apex Court, in ascertaining 'repugnancy' between a central and state enactment, has laid down the following tests:

(1) "Repugnancy must exist in fact, and not rest on a possibility." While establishing repugnancy, the rule of pith and substance cannot be resorted to, because when there are two concurrent state and central enactments on a single subject matter, essentially under the concurrent list, no question of encroaching upon the exclusive jurisdiction of the centre or the state can be contended, since both have the power to enact statutes under the said list.

(2) If the legislature with superior efficacy demonstrates through its legislation that it intends to cover the whole field pertaining to a subject matter, the legislation of the other legislature shall give way to the former. Therefore, in the above case, inconsistency need not be

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established by an exhaustive comparison of provisions of the two legislations, but by the simple fact that there exist two conflicting legislations in the same field.

(3) The inconsistency between the two legislations must lead to different legal results even when applied to the same facts.

(4) In light of the afore-mentioned tests, if the subject matter of the State legislation is indistinguishable from that of the Parliamentary legislation, such that both of them cannot operate together simultaneously, then it is proven that the State legislation is repugnant to the Parliamentary legislation.

(5) Finally, even in the absence of a direct conflict between the state and the parliamentary laws, a state legislation may be inoperative since the Parliamentary legislation is intended to be an exclusive or exhaustive code in itself.

After discussing various judicial precedents, by applying the above tests to the present set of facts, the Apex Court held that the Maharashtra Act, being State Law, dealing with the same subject matter of 'insolvency' as the IBC, is indeed repugnant to IBC (thereby disagreeing with the finding of the NCLAT that there was no repugnancy between the Maharashtra Act and IBC) since the Maharashtra Act stipulates that the State Government may take over the management of the relief undertaking, after which a temporary moratorium is imposed.

Furthermore, it was held that the non-obstante clause present under Section 238 of IBC has contours broader than the one present in the Maharashtra Act, whose application is limited.

Debt: The Apex Court held that when debt becomes due and is unpaid, insolvency resolution process starts, while stating that 'default' under IBC has a wide ambit, and means non-payment of debt (whether in part or in full) once it is due and payable. The Appellant therefore owes a 'financial debt' as defined to the Respondent, and it is immaterial whether the said debt is disputed or not, as long as the 'debt' was payable unless it is specifically prohibited under any law or becomes due on a future date. Only when the adjudicating authority is satisfied that no default has occurred, the application may be rejected, and not otherwise.

Timelines: It was further held that timelines mentioned in IBC are of extreme importance, since time is of essence while scrutinizing whether a corporate body may be able to avoid liquidation or not.

The Hon'ble Apex Court thereby dismissed the appeal preferred by the Appellant, and confirmed the order passed by the NCLT.

Conclusion:

The future course of action for any person filing applications under IBC is now clear owing to the lucid interpretation of law attempted by the Hon'ble Apex Court.

Firstly, it is imperative that the corporate debtor takes all arguments at the first instance, and before conclusion of hearings, thereby directly ensuring that timelines stipulated under IBC are strictly adhered to, since the touchstone of the present insolvency law is speedy disposal of insolvency matters, which not only helps in settling disputes, but may also provide avenues other than liquidation.

Secondly, while interpreting IBC, what must be borne in mind is the object for which it was introduced, i.e. timely resolution of insolvency.

Next, it was reiterated unambiguously that the IBC is a creditor-centric code, and there is no place for oppressive management to continue controlling the reins of a corporate debtor which has failed in paying its legally enforceable debts.

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The committee of creditors shall now be entitled to steer the affairs of the corporate debtor.

Finally, the judgment of the Hon'ble Apex Court acknowledged that by virtue of IBC, there is now 'a paradigm shift in insolvency law' and the statute secures much needed hope for financial and operational creditors. IBC may thus ensure recovery of stressed loans and be utilized as an instrument to propel the country towards attracting more investment and reducing the burden of non-performing assets for debt ridden financial institutions.

[The author is a Senior Associate in Corporate law Practice, Lakshmikumaran & Sridharan, Hyderabad]

Notifications and Circulars

Restriction on number of layers on companies: Ministry of Corporate Affairs *vide* its Notification dated September 20, 2017 has notified the proviso to Section 2(87) of Companies Act, 2013. The notified proviso defines a '*Subsidiary company*' and specifies that such classes of holding companies, as prescribed, shall not have layers of subsidiaries beyond the numbers as may be specified. In furtherance to the notification bringing in force the said proviso, the MCA *vide* its Notification dated September 20, 2017, has notified the Companies (Restriction on number of layers) Rules, 2017.

Henceforth, a company shall not be permitted to have more than two layers of subsidiaries. However, this rule will not affect a company acquiring another company incorporated outside India with subsidiaries beyond two layers as per the laws of those countries. For the purpose of calculating the number of layers under this rule, one layer consisting of one or more wholly owned subsidiaries shall not be taken into account.

The Rules shall not apply to the following companies:

1. Banking Company;
2. A Non-Banking Financial Company which is registered with the Reserve Bank of India and is considered as systemically important i.e. NBFC whose asset size is of Rs. 500 Crore or more;
3. Insurance Company; and
4. Government Company

The Rules further provide that every company which presently has more than two layers of subsidiaries should intimate the Registrar of Companies, in the prescribed form, disclosing the details of such companies within 150 days from the commencement of these Rules.

The Rules specify that, after commencement of the Rules, companies shall not have any additional layer of subsidiaries over and above the layers presently existing. In case one or more of the layers of the companies are reduced after commencement of the Rules, such company shall maintain such reduced number of layers or two layers, whichever is more.

If a company contravenes the provisions of these Rules, it shall be liable to a fine which can extend up to Rs. 10,000 (ten thousand rupees) and if the contravention is a continuing one, a further fine up to Rs. 1000 (one thousand rupees) shall be levied every day till the time the continuation of such contravention.

No change in definition of 'control' as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011: On 8th September, 2017, SEBI issued a Press Release in relation to acquisition of control under the SEBI

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(Substantial Acquisition of Shares and Takeovers) Regulations, 2011. Regulation 2(1)(e) of the said Regulations presently defines 'control' as inclusive of the right to appoint a majority of directors, the right to control the management and the right to control the policy decisions. In March, 2016, a discussion paper had been issued by SEBI exploring bright line tests for acquisition of 'control' under the SAST Regulations and public comments were sought.

Since there was no homogenous response from the stakeholders, no particular option could be adopted. The MCA opined that any change in the definition of 'control' may lead to abuse, therefore, any decision necessitating determination of 'control' ought to be taken on a case to case basis. SEBI decided that the extant definition would not be amended since any change would also have implications under Companies Act, 2013, and other laws, which have similar definitions of the term 'control.'

SEBI Board Meeting – Amendments to SEBI (Infrastructure Investment Trusts) Regulations, 2014 and SEBI (Real Estate Investment Trusts) Regulations, 2014: The Securities and Exchange Board of India in its board meeting held on September 18, 2017, approved certain amendments to the SEBI (Infrastructure Investment Trusts) Regulations, 2014 and SEBI (Real Estate Investment Trusts) Regulations, 2014 to facilitate growth of Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trust (REITs).

The changes proposed in the captioned regulations, *inter alia*, include the following:

(a) Allowing REITs and InvITs to raise debt capital by issuing debt securities;
(b) Introducing the concept of Strategic Investor for REITs on similar lines of InvITs;
(c) Allowing single asset REIT on similar lines of InvIT;
(d) Allowing REITs to lend to underlying Holdco/SPV;
(e) Amending the definition of valuer for both REITs and InvITs

The Board also decided to have further consultation with the stakeholders on a proposal of allowing REITs to invest at least 50% of the equity share capital or interest in the underlying Holdco/SPVs, and similarly allowing Holdco to invest with at least 50% of the equity share capital or interest in the underlying SPVs.

IFSC - Companies (Acceptance of Deposits) Rules, 2014 amended: The Ministry of Corporate Affairs has amended the Companies (Acceptance of Deposits) Rules, 2014 by Notification No. GSR 1172 (E) dated 19th September, 2017. Rule 3 of the said Rules deals with terms and conditions of acceptance of deposits by companies. The Rules now permit a specified International Financial Service Centres (IFSC) public company, i.e. an unlisted public company licensed by RBI/SEBI/IRDA to operate from IFSCs located in approved multi services Special Economic Zone, to accept money from its members, not exceeding 100% of the aggregate of the paid-up share capital, free reserves and securities premium account. Earlier, only private companies were permitted to accept deposits from members in the manner explained above.

The latest Notification also relaxes the norms for acceptance of deposits for certain classes of private companies. Henceforth, the maximum limit of deposits that may be accepted from members shall not apply to (i) a private company which is a start-up, for 5 years from date of incorporation, (ii) a private company which is not an associate or subsidiary company of any other company and whose borrowings from banks or financial institutions or bodies corporate is less than twice its paid up share capital or INR 50 Crores, whichever is less and which has not defaulted in repayment of borrowings subsisting

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at the time of accepting deposits under Section 73 of the Companies Act, 2013.

SEBI (International Financial Services Centres) Guidelines, 2015 – Amendments: In order to ensure investor protection and streamline the operations at International Financial Services Centres (IFSC), SEBI has introduced certain amendments to the SEBI (International Financial Services Centres) Guidelines, 2015 (IFSC Guidelines) *vide* their Circular SEBI/HO/MRD/DRMNP/CIR/P/2017/97, dated August 31, 2017. The following amendments have been introduced in the IFSC Guidelines:

(a) *Credit rating requirement*: In respect of debt securities listed on stock exchanges in IFSC, credit rating shall be obtained either from a credit rating agency (CRA) registered with SEBI or from any CRA registered in a Financial Action Task Force (FATF) member jurisdiction. Herein, the Circular specifies that apart from SEBI-registered CRAs, credit rating can only be obtained from CRAs registered in FATF member jurisdictions.

(b) *Agreement with depository or custodian*: In respect of issuer of debt securities entering into an agreement with depository or custodian for issuance of debt securities, the Circular specifies that the depository or custodian must be registered in a FATF member jurisdiction.

(c) *Reporting of financial statements*: In respect of preparation of statement of accounts by entities issuing / listing their debt securities, the Circular specifies that the statement of accounts must be prepared in accordance with IFRS/US GAAP or accounting standards as applicable to the entity in its place of incorporation. In the event the entity does not prepare its statement of accounts in accordance with IFRS/US GAAP, the entity must prepare a quantitative summary of significant differences between national accounting standards and IFRS and incorporate it in the relevant disclosure documents to be filed with the exchange.

Arrests by SFIO - Commencement of sub-sections 212(8) to (10) of Companies Act, 2013 and Companies (Arrests in connection with investigation by Serious Fraud Investigation Office) Rules, 2017: The SFIO is a multi-disciplinary organization established by the Central Government under the Companies Act, 2013 to deal with the investigation and prosecution of white collar crimes and fraud in companies. Section 212 of the Companies Act prescribes instances wherein the Central Government can cause the SFIO to investigate into the affairs of a company and the procedure to be followed during investigation. By Notification No. S.O. 2751(E), dated August 24, 2017, the Ministry of Corporate Affairs has enforced sub-sections 8, 9 and 10 of Section 212 that gives the SFIO the power to arrest any such persons found guilty of any offence punishable under Section 447 (dealing with fraud) of the Companies Act.

Simultaneously, the MCA also issued the Companies (Arrests in connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, which *inter alia* appoints the Director, SFIO as the competent authority for all decisions pertaining to arrests, other than in cases of investigation into a Government company or a foreign company.

Issuance of Rupee Denominated Bonds Overseas: The Reserve Bank of India, *vide* its Circulars Nos. 5/2017 and 6/2017, dated September 22, 2017 has excluded Rupee Denominated Bonds (RDBs), also known as 'Masala bonds', from the overall limit for investments by Foreign Portfolio Investors in

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corporate bonds, with effect from October 3, 2017. Masala Bonds are presently reckoned both under the Combined Corporate Debt Limit for FPI and External Commercial Borrowings (ECBs). Henceforth, Masala Bonds will no longer form a part of such limit for FPI investments in corporate bonds. Currently, the limit for investment by Foreign Portfolio Investors (FPIs) in corporate bonds is Rs. 244,323 Crore, which includes the limit for issuance of Rupee denominated bonds overseas (Masala Bonds) by resident entities of Rs.44,001 Cr. Such amount of Rs.44,001 Cr - arising from shifting of Masala bonds - will be released for FPI investment in corporate bonds over the next two quarters.

Ratio Decidendi

Limitation Act not applicable for proceedings under Insolvency and Bankruptcy Code - Debentures covered within meaning of 'Financial Debt'

Brief overview

The National Company Law Appellate Tribunal held that the Limitation Act, 1963 is not applicable to the Insolvency & Bankruptcy Code, 2016. NCLAT further held that debentures fall within the meaning of 'Financial Debt' irrespective of the amount of interest attached to them.

Facts

NCLT had admitted the application filed by the Respondent under Section 7 of IBC and ordered moratorium with further order to appoint an Insolvency Resolution Professional. The Appellant had filed an appeal against an Order passed by the National Company Law Tribunal, Mumbai Bench.

Contentions

The Appellant contended that the application filed by the Respondent under Section 7 of IBC was defective, incomplete (since documents provided under Section 7(3) of IBC were not attached to the application) and time-barred (since the debt claimed related to the years 2011, 2012 and 2013). The Appellant further contended that the 'default of debt' as claimed by the Respondent has not been admitted by the Appellant and that the Respondent was not a 'Financial Creditor', but an investor. It was also contended that 'Debenture Certificates' do not fall within the definition of financial debt as provided under Section 5(8) of IBC as they cannot be said to be against consideration for time value of money due to them carrying only zero interest and one percent interest, respectively. The Appellant contended that the Respondent had only purchased the debenture certificates as an investment, and thus would not qualify as a financial creditor.

Observations

NCLAT observed that rules of procedure must be construed so as not to frustrate or obstruct the process of adjudication under the substantive provisions of law.

In respect of the time-bar, NCLAT observed that there was nothing on the record that the Limitation Act, 1963 is applicable to IBC. It also observed that in case there exists a debt which includes interest and there is a default of debt having a continuous course of action, the argument that such debt is barred by limitation cannot be accepted.

NCLAT further made an observation that Section 5(8)(c) of IBC stipulates that any amount raised

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pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument would come within the meaning of 'Financial Debt'. It observed that it was an admitted fact that the Respondent is a debenture holder and the Appellant has a liability in respect of amount which is due to the Respondent being the amount due on maturity of debentures, and that since the Appellant has accepted and not disputed the fact that the amount due to the Respondent has not been paid, there is a 'default of debt' under Section 3(12) of IBC.

Judgment

NCLAT, while dismissing the appeal, held that the Limitation Act, 1963 will not be applicable to proceedings under IBC and that debentures would come within the meaning of 'financial debt', irrespective of the interest rate carried.

Analysis

NCLAT has provided a wider interpretation to Section 7 of IBC, thereby increasing the overall scope and effectiveness of IBC. It is of significant importance that debentures with zero or one percent rate of interest were held to fall within the meaning of 'financial debt' under IBC thereby providing remedy to debenture holders irrespective of the rate of interest applicable on such debentures. NCLAT's observation that Limitation Act will not be applicable to IBC, since IBC relates to initiation of corporate insolvency resolution process and is not meant for recovery of money claims, must be noted.

On the issue of whether the Limitation Act, would apply to this proceeding, Hon'ble Supreme Court of India has kept this question of law open. [*Neelkanth Township and Construction Pvt. Ltd.* v. *Urban Infrastructure Trustees Ltd.* - Order dated 11-8-2017 in Company Appeal (AT) (Insolvency) No. 44 of 2017, NCLAT]

Demerged resultant entity eligible to position itself as a 'financial creditor'

Brief Overview

Financial Creditor made an application to the National Company Law Tribunal, Ahmedabad to initiate insolvency resolution process against Corporate Debtor under Section 7 of the Insolvency and Bankruptcy Code. The Corporate Debtor had availed a term loan from the Financial Creditor *vide* a Working Capital Agreement. The Corporate Debtor had also executed Deed of Hypothecation, Demand Promissory Note etc. Another company had extended collateral in the form of corporate guarantee on behalf of the Corporate Debtor. The Financial Creditor was formed as a result of demerger of the business of Reliance Capital Limited wherein all debts of Reliance Capital Limited were transferred to the Financial Creditor.

The Corporate Debtor had failed to repay the loan amount in terms of the Working Capital Agreement despite repeated requests from the Financial Creditor. The Corporate Debtor also failed to respond to the legal notice issued by the Financial Creditor demanding repayment of loan. *Per* the legal notice, the Corporate Debtor had to settle an amount as on October 12, 2016. Thereafter, the Financial Creditor issued a statutory notice on December 31, 2016 demanding immediate repayment of outstanding loan amount within a period of 21 days. The Corporate Debtor failed in making due repayment of loan amount within the notified period of 21 days.

Judgment

The NCLT ordered that in accordance with IBC, the Adjudicating Authority was required to ascertain the existence of a 'financial debt'. The essence of a 'financial debt' had to be satisfied to initiate an insolvency resolution process against the Corporate Debtor. Upon perusal of the

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documents furnished by the Financial Creditor it was ascertained that the loan would fall under the category of 'financial debt', in accordance with Section 5(8) of IBC. It was further ascertained that both, the Corporate Debtor and the guarantor had failed to repay the loan amount and committed a 'default'.

In case of a financial creditor filing an application to initiate an insolvency resolution process, it is also mandatory for the Adjudicating Authority to ensure that the application is complete in all respects and that the notice has been duly served on the Corporate Debtor. NCLT ascertained the completeness of application and admitted the application and named an Insolvency Resolution Professional to carry out the insolvency resolution process.

Analysis

NCLT stated that in the event a company is formed by the demerger of an existing business and provided that demerger scheme approved by a court of competent jurisdiction states that all debts of the demerged company shall be transferred to the resultant entity, such resultant entity shall be eligible to position itself as a 'financial creditor' in accordance with the terms of IBC. [*Reliance Commercial Finance Limited* v. *Anil Nutrients Limited* – Order dated 23-8-2017 in C.P. (I.B) No. 65/7/NCLT/AHM/2017, NCLT]

Admission of application of Insolvency Resolution Procedure is discretionary upon analysis of Adjudicating Authority

Facts

Standard Chartered Bank and State Bank of India initiated corporate insolvency resolution process under Section 7 of Insolvency and Bankruptcy Code, 2016 read with Rule 4 and 9(1) of Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016. SCB provided a loan worth US $ 413,000,000 to Essar Steel Offshore Limited (ESOL) on January 3, 2014 to refinance its existing loan facility of US $431.1 million. The said loan was secured by a guarantee provided by Essar. On December 7, 2015, SCB issued a notice demanding immediate payment of amount due under the facility agreement which was not serviced by either ESOL or Essar. On January 24, 2017, Essar issued a letter to SCB proposing debt restructuring pursuant to which the outstanding amount would be paid by the end of 25 years along with an interest at 1% per annum, however, SCB rejected the said structuring proposal. Consequently, SCB initiated the corporate insolvency resolution process in respect of Essar to safeguard public interest and for the benefit of all the creditors of Essar. Further, Essar also had an outstanding debt of Rs. 1,48,60,82,00,000 in favour of SBI. In pursuance of the same, SBI filed all documents and made an application for initiating the corporate insolvency resolution process along with SCB. They also proposed the name of the interim insolvency resolution professional.

Contentions

Essar contended that the word "may" used in Section 7(5)(a) of IBC showed legislative intent of giving Adjudicating Authority the discretionary power to reject an application of insolvency resolution process. Essar argued that since it was not a wilful defaulter and there was no diversion of funds, fraud or malfeasance, the application must not be admitted. It also argued that complexities such as existence of a debt reconstruction scheme must also be taken into consideration before admitting the insolvency resolution process.

Further, it was contended that there was no compulsion of appointing an IRP on the same day on which an application is admitted as there is a 14-day time limit granted to admit an application and the same should be made

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available for appointment of an IRP as well. They also contended that the application filed by SBI was not signed by a competent authority.

SCB contended that the word "may" used in Section 7(5)(a) of IBC should instead be read as "shall" in the context of initiating a corporate insolvency resolution process to ensure that once the Adjudicating Authority is satisfied about the fulfilment of other requirements, the application cannot be rejected.

It was further contended that no special relief was granted to Essar in the Gujarat High Court ruling of *Essar Steel India Limited and Another v. Reserve Bank of India and Others* and hence the application under Section 7 of IBC must be admitted.

Observations

The Court relied on the observations made in *Essar Steel India Limited and Another* v. *Reserve Bank of India and Others*. The Adjudicating Authority in the said order took the view that admission of an insolvent application filed by a financial creditor is not a routine order and the Adjudicating Authority must exercise their judicious discretion to admit the same. Hence the admission of an application is discretionary.

It was further observed that the Adjudicating Authority should cross check for the following before admitting an application; a) whether any default has occurred for initiating insolvency resolution process (b) whether the application for insolvency resolution process is complete and (c) whether any disciplinary proceeding already exists against the nominated IRP.

In the present matter, the Adjudicating Authority observed that as per the material placed on record by SCB and SBI, it is established that Essar had committed default in repayment of financial debt and there are no pending disciplinary proceedings against the IRP proposed by the applicants.

Judgment

The Adjudicating Authority admitting the application of Insolvency Resolution Process against Essar made the following observations:

(a) SCB and SBI are financial creditors and Essar had defaulted in payment; and
(b) The factual details of Debt Restructuring Process and appointment of IRP do not hamper the commencement of the Insolvency Resolution Process.

Analysis

The Court has taken a clear stance while interpreting Section 7(5)(a) of IBC stating that "may" must be interpreted as "may", and not "shall". In other words, as per the intention of the legislature, the admission of an application of an Insolvency Resolution Procedure is discretionary upon the analysis of the Adjudicating Authority. The judgment also provides clarity on the timeline for appointing an IRP and the importance of a pending Debt Restructuring Process. [*Standard Chartered Bank Ltd. And Ors.* v. *Essar Steels India Limited* – Order dated 2-9-2017 in IA 152/2017, C.P. (IB) No. 39/7/NCLT/AHM/2017 and C.P. No. (I.B) 40/7/NCLT/AHM/2017, NCLT, Ahmedabad]

Parallel proceedings against guarantors cannot be admitted when moratorium under Insolvency and Bankruptcy Code, 2016 is in force

Key points

- The National Company Law Tribunal shall be the adjudicating authority under the provisions of the IBC with respect to insolvency resolution and liquidation of corporate persons including personal guarantors thereof.
- When the liability of the principal debtor has not been crystalized under the corporate insolvency resolution process initiated before

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the NCLT, parallel proceeding initiated against the guarantors of principal debtor shall be stayed till finalization of corporate insolvency resolution process or till the NCLT approves the resolution plan.

In the present case, the petitioners were the former directors of the Company, Lohia Machines Limited (Company), which was declared "sick" by the erstwhile Board of Industrial and Financial Reconstruction. The State Bank of India (SBI) being the creditor, filed a suit for recovery of its debts before the Debt Recovery Tribunal, Allahabad (DRT) against the Company as well as the current petitioners who were the personal guarantors of the loan availed by the Company from SBI. However, in the meantime the Company filed an application before NCLT, Allahabad seeking initiation of corporate insolvency resolution process. Accordingly, the NCLT allowed the application and passed an order initiating the insolvency process and declaring a moratorium as per Section 14 of the IBC. The said order also made provisions for the appointment of an insolvency professional and directed the issuance of a public announcement informing the initiation of the insolvency process and calling for submission of claims. Numerous claims were received from various creditors in response, which included SBI, who also participated in the meeting of the committee of creditors called by the insolvency professional thereafter.

Upon examination of the NCLT order and the relevant provisions of the IBC, the DRT stayed its proceedings against the Company recognizing that the provisions of IBC will prevail over the provisions of the Recovery of Debts Due to Banks & Financial Institutions Act, 1993. However, the single judge of the DRT was of the considered opinion that the order passed by the NCLT was qua proceedings against the Company being a corporate entity and that there is no direction to restrain proceedings against individual guarantors/mortgagors who gave their personal guarantees. Therefore, the DRT was of the view that the present proceedings could continue against the petitioners. Further, the DRT observed that the intention to file insolvency proceedings in the NCLT by the Company and the current petitioners was to delay the recovery proceedings in the DRT. Aggrieved by the said order, the present writ was filed by the petitioners before the Allahabad High Court.

Single Judge Bench of the Allahabad High Court observed that at no point of time had SBI disassociated itself from the proceedings before the NCLT and was actively participating in the proceedings. At this point, reference was also made to the ratio of the judgement in *Oshi Foods Limited and Ors. vs. State Bank of India*, wherein the Single Judge of the High Court of Madhya Pradesh had held that unless and until the liability of the company is determined, the guarantors cannot be held liable. Relying on the aforesaid decision and the provisions of the IBC, the Single Judge of the Allahabad High Court was of the considered opinion that since the (i) creditor bank has sufficient safeguards under the provisions of the IBC and regulations framed thereunder; and (ii) the liability has not been crystallized either against the principal debtor or guarantors at present, the proceedings before the DRT cannot go on and the same shall be stayed till the finalization of corporate insolvency resolution process or till the NCLT approves the resolution plan in accordance with Section 31(1) or passes an order for liquidation of corporate debtor under Section 33, as the case may be. [*Sanjeev Shriya* v. *State Bank of India* – Order dated 6-9-2017 in Writ Petition (C) No. 30285 and 30033/2017, Allahabad High Court (Single Judge)]

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NEW DELHI
5 Link Road, Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave
New Delhi -110 029
Phone : +91-11-4129 9900
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park, Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden, 2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax:+91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church,
Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail :lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune-411 001.
Phone : +91-20-6680 1900
E-mail :lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road,
Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59,
Sector 26,
Chandigarh -160026
Phone : +91-172-4921700
E-mail :lschd@lakshmisri.com

GURGAON
OS2 & OS3, 5th floor,
Corporate Office Tower,
Ambience Island,
Sector 25-A,
Gurgaon-122001
phone: +91-0124 - 477 1300
Email: lsgurgaon@lakshmisri.com

ALLAHABAD
3/1A/3, (opposite Auto Sales),
Colvin Road, (Lohia Marg),
Allahabad -211001 (U.P.)
phone . +91-0532 - 2421037, 2420359
Email:lsallahabad@lakshmisri.com

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