Insolvency & Bankruptcy

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Insolvency and Bankruptcy Code of India

The Insolvency and Bankruptcy Code, 2016 ("**Code**"), since its inception has gained prominence in India as it is a comprehensive code ensconcing in itself the entire insolvency law regime in India. When this law was brought into force, the provincial and presidential insolvency regimes were repealed along with amendments to eleven extant legislations.[1] The Code has been given a hearty welcome because of the much needed changes it has introduced to our insolvency regime, *inter alia,*:

- Introduction of strict timelines for completion of each stage of insolvency thereby solving the erstwhile problem of ever-continuing winding up cases;
- Institution of a regime of 'Creditor in control' by changing the erstwhile regime of 'Debtor in possession';
- Provision of an insolvency professional to manage the assets and affairs of the corporate debtor. This has been done to solve the problem of "asset stripping";
- Overriding effect on all other laws[2] and aiming to resolve insolvencies in a strict time-bound manner; and
- Setting up of an Insolvency and Bankruptcy Board of India as an independent body for the administration and governance of Insolvency & Bankruptcy law in India.

The story so far:

As per the Insolvency and Bankruptcy Board of India, between the first quarter of 2017 to the end of the first quarter of 2018:

- CIR Process was admitted in respect of 701 corporates[3];
- Resolution Plan was admitted in respect of 22 companies; and
- Liquidation process was commenced in respect of 87 companies.

The present note is divided into two parts – Part I deals with some of the prominent case law advancing the interpretation of the Code and its implementation. Part II is a short note on Cross Border Insolvency, which is part of the second report of the Injeti Srinivas Insolvency Committee.

Part –I : Prominent Decision

State Bank of India v. Bhushan Steel Limited

Corporate insolvency process ("**CIR Process**") was initiated in respect of India's largest NPA on 26 July 2017, after an application was made by State Bank of India under Section 7 of the Code. As on 15 May 2018, the Resolution Plan approved by the Committee of Creditors has been sanctioned by the Hon'ble National Company Law Tribunal ("**Adjudicating Authority**"/ "**NCLT**") at New Delhi. The entire process of resolution was completed within 293 days. This was one of the largest NPAs of India and appears to be a success story in terms of the speedy resolution of the debts of the Corporate Debtor under the Code.

Arcelor Mittal India Private Limited v. Satish Kumar Gupta & Ors

The Hon'ble Supreme Court in this case adopted a purposive interpretation of Section 29A of the Insolvency & Bankruptcy Code, 2016 ("**Code**"). Drawing distinction between the Ordinance of 2017 and Amendment Act of 2017 (which introduced section 29A), the court pointed out that the addition of the words 'persons acting in concert' to Section 29A and by shifting of the words "Promoter" and "Management" from the

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opening words of the section, highlights the intention of the legislature to rope in all persons who may be acting in concert with the person submitting a resolution plan. In this context of purposeful and contextual interpretation, the court held that when it comes a corporate vehicle that is set up for the purpose of submission of resolution plan, it is not only permissible but imperative for the competent authority to find out the constituent elements that make up the company. Moreover, the Hon'ble Court also laid down that the ineligibility under Section 29A (c) can only be removed if the resolution applicant makes payment of all overdue amounts with interest thereon and charges relating to the non-performing asset in question before submission of a resolution plan.

Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors.

This case is a landmark case of upholding the constitutional validity of the Code in its entirety. The case had many key holdings relevant for the jurisprudence of the subject of Insolvency and Bankruptcy in India like **(a)** The Code is a beneficial legislation which puts the Corporate Debtor back on its feet, not being a mere recovery legislation for creditors; **(b)** The Preamble of the Code does not, in any manner, refer to liquidation, which is only availed of as a last resort if there is either no resolution plan or the resolution plans submitted are not up to the mark; **(c)** there is an intelligible differentia between the Financial Creditors and Operational Creditors which has a direct relation to the objects sought to be achieved by the Code. Classification between Financial Creditors and Operational Creditors is neither discriminatory, nor arbitrary, nor violative of Article 14; **(d)** The Committee of Creditors has the primary responsibility of financial restructuring. It assesses the viability of a Corporate Debtor by taking into account all available information as well as to evaluate all alternative investment opportunities that are available. It evaluates the resolution plan on the basis of feasibility and viability; **(e)** Regulation 30A(1) of the CIRP Regulations is not mandatory but is directory for the simple reason that on the facts of a given case, an application for withdrawal may be allowed in exceptional cases even after issue of invitation for expression of interest under Regulation 36A. **(f)** Resolution Professional has no adjudicatory powers. He has administrative powers as opposed to quasi-judicial powers. The RP is really a facilitator of the resolution process, whose administrative functions are overseen by the Committee of Creditors and by the Adjudicating Authority.

Dharani Sugars v. Union of India, the validity of the 12 February RBI Circular

The Supreme Court, in the matter of Dharani Sugars and Chemicals Ltd v Union of India & Ors, has held that the RBI circular of 12 February 2018 which promulgated a revised framework for resolution of stressed assets is ultra vires section 35AA of the Banking Regulation Act 1949. Consequently, all the cases filed by financial creditors against corporate debtors under Section 7 of the Insolvency and Bankruptcy Code (IB Code) in pursuance only of this circular are proceedings that have been declared to be non est. While the Hon'ble Supreme Court upheld the validity of Section 35AA and Section 35AB of the Banking Regulation Act, however, as regards the 12 February 2018 circular the Hon'ble Supreme Court disagreed with the petitioners that section 35A as the source of power for authorizing the Circular could not be relied upon because it is an old provision introduced in 1956 when the invocation of the IB Code was not even contemplated by Parliament. Further, the Hon'ble Court discussed that Section 35AA provides that the Central Government may, by order, authorize the RBI to issue directions to any banking company or banking companies to initiate insolvency resolution process in respect of a default under the provisions of the IB Code. It was important to note that without the authorization of the Central Government the RBI would have no such power nor could it issue such directions. Further, such authorization should be in respect of specific defaults. Further support was derived from the Press Note of 5 May 2017, which introduced the Banking Regulation (Amendment) Ordinance 2017 which specifically referred to resolution of "specific" stressed assets which will empower the RBI to intervene in "specific" cases of resolution of NPAs. The Statement of Objects and Reasons for introducing Section 35AA also emphasized that directions are in respect of "a default". It was therefore clear that directions that can be issued under Section 35AA can only be in respect of specific defaults by specific debtors. Any directions which are in respect of debtors generally would be ultra vires Section 35AA.

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The case of Rajputana Properties Private Limited vis a vis Binani Cements Limited and Ultratech Cement Limited

In this case, the lenders had filed an application for initiation of CIR Process in July 2017 and while the lenders initially approved the resolution plan of Rajputana Properties Limited. However, upon the directions of the NCLT, Kolkata in an application filed by UltraTech Cement Limited, the then unsuccessful resolution applicant for consideration of a higher offer submitted after the last date of submission as per the Process Document, the NCLT, Kolkata set aside a concluded bidding process. Besides the above, the objections to the Resolution Plan were filed by: Operational Creditors for non-payment of their entire claims; Objections filed by Exim Bank and SBI Hong Kong, for non-payment of their entire admitted amount; and an application for termination of CIR Process was filed by the Binani Industries Limited for termination of the CIR Process basis an understanding with UltraTech for sale of shares of Binani Cement even though Binani Cement was under insolvency and the process had almost culminated.

While the resolution plan of UltraTech was finally approved by the NCLAT and upheld by the Hon'ble Supreme Court, however, in our opinion the same has set a precedent whereby a toppling bid by an unsuccessful resolution applicant allowed the setting aside a concluded bidding process, based on applications filed by the UltraTech - an unsuccessful resolution applicant.[4] Not unlike case of Bhushan Power and Steel Limited, the Adjudicating Authority itself formed a new procedure for bidding between the successful resolution applicants and one of the unsuccessful resolution applicant which had already participated in the process. The Adjudicating / Appellate Authority also erred in not appreciating the detailed procedure laid down in the Process Document (which contained specific timelines to be followed) and also disregarded the principle of timely resolution which forms the foundation of the Code.

The emerging learnings from this leading case are:

The Applicants and their investment advisors should carefully submit documents to satisfy eligibility and evaluation criteria.

- The CIR process is ordinarily regulated through a "process document" issued by the CoC under the mandate of Section 25(2)(h) of the Code read with Regulation 36A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. The process document is similar to a tender document, and must be complied with to the fullest.
- If there are mistakes, the resolution plan may be rejected. If there are revisions, then the resolution plan may become unresponsive, and open to questions from other resolution applicants. Therefore, there should be audit of the resolution plans before they are submitted to the CoC.
- The compliance of Section 29A of the Code is a critical factor, which has to be honestly and strictly followed. No devices should be resorted to circumvent Section 29A.

Litigation is an Inherent Risk

Litigation constitutes an inherent risk to the speedy resolution of corporates. However, the recent amendments to the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016[5] may help in dealing with so many litigations that plague ongoing cases of insolvency.For instance, amendment to Section 29A(c) negates the complications / litigation which were faced in the Essar Steel Matter or introduction of settlement option reduces the chances of the promoter interfering in the insolvency resolution.

Early due-diligence is important

It is expected that Section 29A compliance by corporates will be made mandatory before access is granted to the information memorandum, and that may happen almost 3 months after the insolvency commencement date. Accordingly, early due diligence from public sources (to the extent possible) becomes important.

Other learnings

The CoC should clearly specify the eligibility and evaluation criteria so that there is no ambiguity. Ambiguity leads to disputes. The process documents need to be carefully drafted, as any discrepancy in the process will lead to a dispute. As an operational creditor, claims must be filed in time with supporting documents, otherwise they will be written off or not accepted.

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Opportunities that the Code provides to the corporate-legal world

The Code has created a huge new market for stressed asset M&A where multiple potential acquirers would submit their expression of interest, conduct a due-diligence and prepare a resolution plan. This opens up new avenues for investment bankers and law firms alike, where even though the ultimate acquirer may be just one, the insolvency process is conducted like an M&A transaction until the very end. Payments pursuant to a resolution plan would require refinancing of existing debt. In each case, there is huge scope for banking and finance teams. For example: a resolution applicant needs to show proof of funds along with the resolution plan, and for this it must tie-in its funds through sanction letters or letters of comfort. For this, a detailed evaluation is generally required. Implementation of a resolution plan and integration of a corporate debtor with the acquirer is also an area that requires constant support from advisors.

Part II – Cross Border Insolvency

In India presently, there is no extant framework for cross border insolvency. The current method of enforcement of decrees (including such decrees which have been passed by foreign courts) is governed by the Code of Civil Procedure 1908, which is the applicable procedural law for civil cases.

Presently, in relation to Cross Border Insolvency, the Code stipulates that:

- the government can enter into agreements with other countries to enforce the Code; and
- the NCLT can issue the authority to write a letter to the courts and authorities of other countries to seek information or request action in relation to the assets of the debtor situated outside India.

India has not yet adopted the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency - Entering into individual bilateral agreements would be a cumbersome and lengthy process.

The Insolvency Law Committee ("**ILC**") submitted its second report to the Government of India regarding cross-border insolvency matters and has recommended the adoption of the UNCITRAL Model Law on Cross-Border Insolvency, 1997 ("**Model Law**") with suitable modifications for the Indian context. It recommends the insertion of 'Part Z' into the Code to provide for the following in relation to countries which have also adopted the Model Law (the Central Government may notify more countries later):

- access to Indian courts by foreign insolvency professionals;
- recognition of foreign insolvency proceedings and provision of appropriate relief;
- co-operation between domestic and foreign insolvency professionals, domestic courts and foreign insolvency professionals and domestic insolvency professionals and foreign courts; and
- co-ordination of concurrent insolvency proceedings in different jurisdictions.

Insolvency of enterprise groups across jurisdictions has been omitted, for redressal in future, upon evolution of the international framework for the same.

Set out below are the key recommendations of the ILC and the proposed provisions of Part Z sought to be introduced into the Code:

Recognition of foreign insolvency proceedings and other relief

The ILC has proposed to provide for recognition in India of foreign insolvency proceedings with respect to a corporate debtor (whether registered in India or abroad). The application for recognition is required to be decided by NCLTs within 30 days (extendable by another 30 days).

A "foreign proceeding" is defined to mean "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the corporate debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation". Such proceedings may be foreign 'main' proceedings or foreign 'non-main' proceedings. The relief available in respect of a foreign main proceeding and a foreign non-main proceeding varies: while an automatic moratorium (akin in nature and scope to the moratorium granted in respect of

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a domestic corporate debtor under the Code) is to be granted in respect of a foreign main proceeding, such relief is discretionary in respect of a foreign non-main proceeding. Additionally, upon recognition of a foreign proceedings, the foreign representative would be entitled to, inter alia:

- participate in a proceeding under the Code regarding the corporate debtor;
- make an application to the Adjudicating Authority in relation to fraudulent and preferential transactions of the corporate debtor; and/or
- request the Adjudicating Authority to entrust to him/her the distribution of the assets of the corporate debtor located in India.
- The domestic resolution professional and notified benches of the Adjudicating Authority may provide additional assistance to the foreign representative.

COMI and establishment

A 'foreign main proceeding' is a foreign proceeding taking place in the country where the corporate debtor has its 'centre of main interests' ("**COMI**"). There is, akin to the Model Law, a rebuttable presumption that the registered office of a corporate debtor is its COMI. However, in order to prevent forum shopping a look-back period of 3 months has been recommended for the determination of COMI in addition to an assessment by the Adjudicating Authority of where the corporate debtor's central administration takes place and which is readily ascertainable by third parties. The Central Government may prescribe additional factors for determination of COMI.

On the other hand, a 'foreign non-main proceeding' is a foreign proceeding taking place in a country where the corporate debtor merely has an establishment. The term 'establishment' has been defined, in line with the Model Law, as any place of operations where the corporate debtor carries out a non-transitory economic activity with human means and assets or services.

Access to Indian forums by foreign representatives

An application for recognition of the foreign proceedings is to be made to the Adjudicating Authority by a 'foreign representative', defined in the draft Part Z as "a person or a body authorized in a foreign proceeding to administer the reorganization or the liquidation of the corporate debtor's assets or affairs or to act as a representative of the foreign proceeding and includes any person or body appointed on an interim basis". While Article 9 of the Model Law provides for direct access to the courts of an enacting jurisdiction by a foreign representative, the ILC has recommended that the exercise of the powers and functions by a foreign representative under Part Z is to be in a "manner as may be prescribed", in view of the established position in Indian law that foreign lawyers and law firms are not permitted to practise law in India.

Public policy exception

In line with the Model Law, the Adjudicating Authority may refuse to recognize foreign insolvency proceedings or grant any relief therefor if such action would be manifestly contrary to the public policy of India. The Central Government will have a right to be heard with respect to actions that may be manifestly contrary to the public policy of India.

Co-operation between the Adjudicating Authority and foreign courts and concurrent proceedings

The guidelines for communication and co-operation between the Adjudicating Authority and the foreign courts are to be notified by the Central Government, and may include co-ordination of the administration of the corporate debtor's assets.

Upon the recognition of a foreign main proceeding, a corporate insolvency resolution process under the Code may be commenced against a corporate debtor, only in respect of the assets of the corporate debtor in India. However, if such proceeding commences after the recognition of a foreign proceeding, the relief granted in respect of the foreign proceeding would be subject to modification in consonance with the corporate insolvency proceedings under the Code. Similarly, if a insolvency resolution proceeding under the Code commences after the recognition of a foreign proceeding, the relief granted in respect of such foreign proceeding would be reviewed and modified accordingly.

Regulation of the foreign representatives

A foreign representative would be subject to

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monetary penalties for contravention of any of the provision of Part Z of the Code. The Insolvency and Bankruptcy Board of India may also prescribe a code of conduct for such professionals, and the Central Government may require such professionals to be registered with the Insolvency and Bankruptcy Board of India.

Access of foreign creditors

The Code already provides for initiation of insolvency proceedings against a corporate debtor by a foreign creditor (as a financial or an operational creditor), filing of claims by such foreign creditor and participation in the corporate insolvency resolution process as contemplated under the Code. Foreign creditors would also be subject to the waterfall envisaged in the Code for payments to be made to creditors and will not be ranked lower than the general residuary category of claims envisaged in the Code (provided there is no equivalent domestic claim which has a lower rank), however, an exclusion has been made for social security claims and foreign tax, in line with the Model Law.

The ILC has further recommended that the Insolvency and Bankruptcy Board of India may prescribe a separate mode of notice to foreign creditors of a proceeding under the Code.

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1 Please see Schedule 11 of the Code.

2 Section 238 of the Code.

3 The Reserved Bank of India had by way of its first circular directed banks to commence the insolvency process in respect of 12 prominent corporates in the field of steel, power, infrastructure, textiles, real estate. These corporates constituted around 25% of India's NPA

4 The same was affirmed by the NCLAT vide its order dated 14 November 2018 and by the Hon'ble Supreme Court vide order dated 19 November 2018.

5 As amended on 5 October 2018.

Please feel free to address any further questions or request for advice to:

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