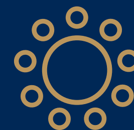


Shardul Amarchand Mangaldas

Evolving Landscape of
Insolvency Law in India

Evolving Landscape of Insolvency Law in India

Introduction

The law relating to Insolvency and Bankruptcy in India has recently become a hallmark of dynamism with the passage of the Insolvency and Bankruptcy Code, 2016 (Code or IBC) and is witnessing new horizons. The legal regime has undergone a paradigm shift to reach a position where the law is facilitating faster resolution of stressed assets, while also opening avenues for acquisition of businesses as going concerns. India has evolved from a slow, bureaucratic system under a multitude of legislations such as Sick Industrial Companies Act, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, and Recovery of Debt Due to Banks and Financial Institutions Act, to one where the insolvency resolution process is streamlined under a consolidated Code and only two adjudicating authorities are involved – a departure from the old framework that involved multiple fora.

Although having received wide-spread acclaim at resolving the stress situation in the country's financial system, the Code, still in its nascent stages, requires further fine tuning to iron out issues experienced with growing practical experience. To keep pace, the legislature and the Insolvency and Bankruptcy Board of India (IBBI), a dynamic institution, have been proactive in making amendments to the Code and the regulations to address the shortcomings exposed and doubts created in insolvency resolution processes. This effort is being further supplemented by the judiciary by putting to rest various issues that have been creating a great deal of ambiguity in giving effect to the provisions of the Code. Other stakeholders such as the Securities and Exchange Board of India (SEBI) (discussed later) and Ministry of Corporate Affairs have also notified various changes to further streamline the corporate insolvency resolution process to further advance the objectives of the Code.

Anomalies in the Previous Framework

The previous legal framework that dealt with cases of insolvency suffered from various defects which made it more difficult for lenders to recover debts from insolvent entities, which was further marred by delays and consequent deterioration of value. The process took several years for liquidation of the debtor company. Since the debtor company remained in the hands of the promoters and extant management, often there was very little value left for the lenders to recover. Various RBI schemes such as Corporate Debt Restructuring, Joint Lenders Forum, Scheme for Sustainable Structuring of Stressed Assets (S4A), Strategic Debt Restructuring etc also failed to yield results. Lack of availability of quality information and in quantity required by potential bidders also acted as a major impediment. Under the new law, the resolution professional provides information about the corporate debtor through various modes, the information memorandum being one of them. The new framework provides a time-bound process wherein the first objective is to continue the company as a going concern, preserving its assets, and thereby, the value of the company. The Code marks a significant departure from a debtor in control to creditor in control model, wherein the resolution professional takes control of the corporate debtor and the Code imposes an obligation on the personnel of the corporate debtor to cooperate with the resolution professional.

Brief Overview of the Insolvency Resolution Process under the Code

When a corporate debtor defaults in repayment of dues, Corporate Insolvency Resolution Process (CIRP) can be initiated by a financial creditor under Section 7, by an operational debtor under Section 9 or by the corporate debtor itself under Section 10 of the Code, by making an application to the National Company Law Tribunal (NCLT). Admission by NCLT results in imposition of a moratorium, i.e. a calm period wherein the insolvency resolution can be carried out without caring about any

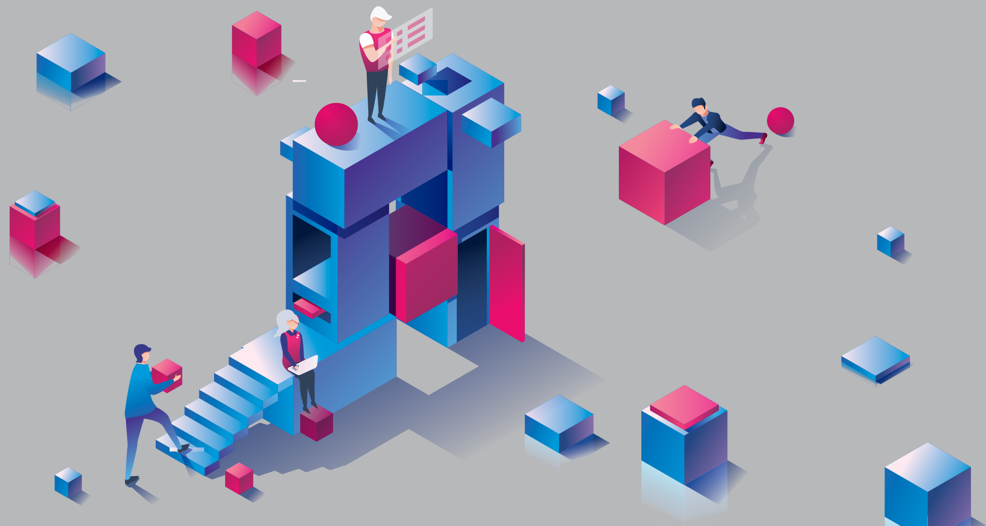
proceedings that are continuing or may be instituted against the corporate debtor such that resolution can be focused upon, under Section 14. Upon admission of the application, the NCLT appoints an interim Resolution Professional (RP) who takes the control of the corporate debtor's assets and functioning, within 14 days of acceptance of the application. The interim RP holds office for 30 days, during which he takes control of the corporate debtor's assets and operations, and collects financial information of the corporate debtor, including from information utilities. The NCLT also makes a public announcement about the commencement of CIRP, inviting claims from creditors. The interim RP constitutes the Committee of Creditors (CoC) comprising of the financial creditors, but a financial creditor who is a related party of the corporate debtor does not have a right to represent, participate or vote in the CoC. Operational creditors are to be part of the CoC, without voting rights, if their aggregate dues are not less than 10% of the debt. Within 7 days of its constitution, the CoC decides whether the interim RP should continue as the RP. As per Section 12, the CIRP must be concluded within 180 days from the date of admission of the application by the NCLT. If the CoC finds the case complex, the NCLT may grant a one-time extension of a maximum of 90 days. The CoC takes decisions regarding insolvency resolution, while the RP conducts the process and manages the corporate debtor during the period. The RP is required to prepare an information memorandum so as to enable resolution applicants (RAs) to prepare a resolution plan (plan). Upon receipt of the plans from RAs, the RP performs a compliance check of the same, and the CoC deliberates and approves one of the plans, with a majority of 66%. The plan is then sent to NCLT for approval. In case the CoC does not approve of any of the plans submitted, the corporate debtor goes into liquidation.

Strengthening the Debt Market and Business Landscape

The Code is a path-breaking legislation, welcomed as a breath of fresh air. It is revitalising the staggering debt market in India that is reeling under the enormous pressure of non-performing assets, bad debts and banking frauds. In nearly two years of its operation, the Code has been a game-changer for all stakeholders in the country. Creditors have witnessed improved recovery of debts, and on the other hand, the Code has also facilitated revival of closed assets such as the Sirpur Paper Mills.

The Code consolidates the extant laws making it easier for businesses to navigate the legal landscape, while also providing a time-bound resolution process which transfers control of the stressed asset from the defaulting directors / promoters to the creditors through the RP during the resolution process. Like every other new legislation, the Code has also been subject to various interpretational challenges – however, the judiciary, including the National Company Law Tribunal, the National Company Law Appellate Tribunal and the Supreme Court, has been an active participant in providing a texture to the Code which is conducive for business and for the overall growth of the economy. It is also notable that the resolution plan approved by the CoC and also approved by the NCLT under Section 31 of the Code, which makes the plan binding on the corporate debtor, its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. This provides a great degree of certainty to the process.

With the advent of the Code, India has made a leap in ranks in both the World Bank's Ease of Doing Business and the World Economic Forum's Competitiveness Index by more than 30 places in the period between 2015 and 2017. It is providing a lease of life to stressed assets in India and an opportunity to potential acquirers to re-run



these businesses with enhanced vigour. It can rightfully be called the hallmark of a reformed commercial-legal setup that welcomes investment and makes business profitable.

Opportunities for Investment

The Code has opened new avenues for domestic acquirers, who are on the lookout for business expansion prospects, as well as foreign investors who seek to mark their presence in the opportunity-abounding Indian market. Enabling the successful resolution applicant to acquire extant businesses and run them with sustainable debts – the new law presents a worthwhile platform for investors, especially foreign companies to expand in the South Asian economic behemoth. The Code has also shown sensitivity towards the continuous need for businesses to reform, design new strategies and structures for producing goods and services and reaching out to customers. Its in-built flexibility provides acquirers the space for creating innovative business plans that investors often desire in this dynamic business landscape. While the conventional principles of acquisition continue to apply, the investor is given the liberty to structure the acquisition in any manner which is commercially and legally feasible, and the Code has ensured that all these existing principles are now streamlined and moulded into a more certain and time-bound process which ultimately has the approval of the National Company Law Tribunal, giving the certainty of implementation. The plan, with the blessings of the court, becomes binding on all parties which grants certitude to the situation, and a drastically reduced potential of protracted disputes. With the new timeline-driven regime, creditors are looking forward to an expedited resolution process, while new investors are keen to enter the market or expand for attractive prices in an expeditious process, which is a very welcomed changed in an otherwise slow legal framework.

Legislation and Interpretation – the Two-Pronged Act

Both the legislature and the judiciary have been proactive in their engagement with insolvency laws. While the IBC is possibly the one legislation which has received maximum scrutiny within its first two years, the Parliament has been quick to take note of impediments, and the concerned forums have continuously been pivotal in settling disputes and developing jurisprudence around the Code which provides guidance to every subsequent process being carried out. Here are some key developments in Insolvency law framework:

Withdrawal of application for initiation of corporate insolvency resolution process

A significant development brought about by the Insolvency and Bankruptcy Code (Amendment) Ordinance 2018 and consequently the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 has been the introduction of an out-of-court settlement process.

Previously, the Code did not provide for withdrawal of proceedings once the corporate insolvency resolution process was initiated. However, there were certain instances where on account of settlement between the applicant creditor and the corporate debtor, judicial permission for withdrawal of corporate insolvency resolution process had been granted by Supreme Court (for instance in the case of *Lokhandwala Kataria Construction Private Limited* v *Nisus Finance and Investment Managers LLP*).

A strict procedure has now been provided for the withdrawal of a case by an applicant after it has been admitted under the Code – in terms of Section 12 A of the Code, read with Regulation 30A of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations,

2018 (CIRP Regulations), the procedure for withdrawing an application has been set out. The application can be filed only before the publication of notice inviting expressions of interest, and there can be no withdrawal once the process of submission of expressions of interest and bids commences. The committee of creditors must consider the application within seven days of its constitution or seven days of receipt of the application, whichever is later. If the application is approved by the committee of creditors with 90% voting share, the resolution professional must submit the application to the NCLT on behalf of the applicant, within three days of such approval.

It should however be noted that the amendments to the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2018 including the newly inserted Regulation 30A are effective only with respect to corporate insolvency resolution processes which have commenced after July 3, 2018.

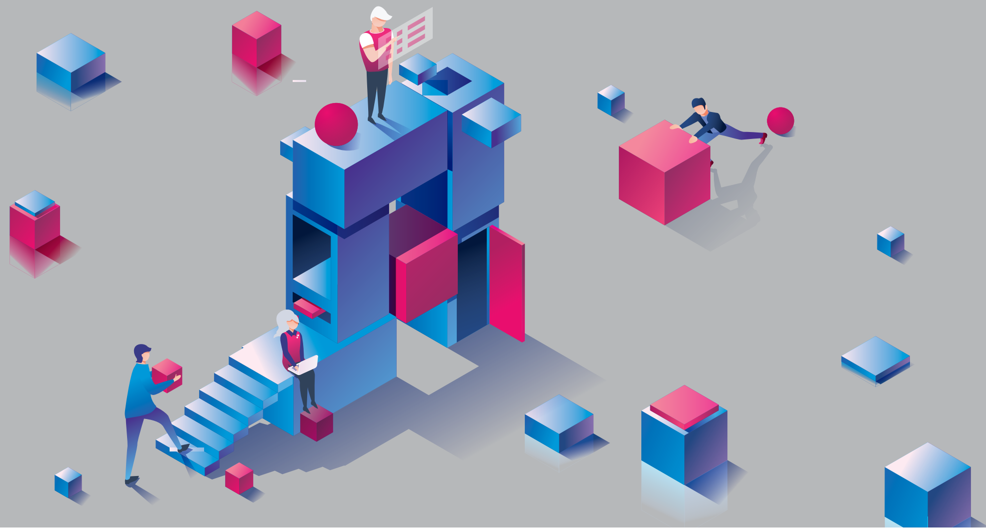
Application of Law of Limitation to the Code

Section 238A has been introduced by virtue of Insolvency and Bankruptcy Code (Amendment) Ordinance 2018 and consequently the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, which makes the Limitation Act, 1963 (Limitation ACt) applicable to proceedings under the IBC, which is a due acknowledgement of the maxim *Vigilantibus non dormantibus jura subvenient,* i.e. the Law helps those who are vigilant and not those who sleep over their rights.

A question that was being raised time and again was whether the Limitation Act applies to applications that are made under Section 7 or 9 of the Code between 01.12.2016 (date of commencement of the Code) and 06.06.2018 (date of amendment which introduced Section 238A). In all such cases, NCLAT held that the Limitation Act does not apply for the said period, on the grounds that if a law is a complete code, then an express or necessary exclusion of the Limitation Act should be respected.

However, the Supreme Court has set this issue to rest through its judgment in the case of *B. K. Educational Services Pvt. Ltd.* Vs. *Parag Gupta and Associates*. It has held that the Limitation Act is applicable to applications filed under Section 7 and 9 of the Code from the very inception of the Code. The right to sue accrues when a default occurs. If the default has occurred over three years prior to the date of filing of the application, it would be barred under Article 137 of the Limitation Act, save and except in those cases where, in the facts of the case, Section 5 of the Limitation Act may be applied to condone the delay in filing such application. It was also noted that according to the Report of the Insolvency Law Committee of March, 2018, the intent of the Code could not have been to give a new lease of life to debts which are time-barred. It now stands clarified that Section 238A of the Code being clarificatory of the law and being procedural in nature, acts retrospectively, as otherwise, applications seeking to resurrect time-barred claims would have to be allowed.

Section 408 of the Companies Act, 2013 (Companies Act) states that the NCLT is set up to discharge such powers and functions that are conferred on it not merely under the Companies Act but also under "any other law for the time being in force". Section 433 provides for application of Limitation Act to proceedings before the NCLT, but it does not use the phrases "under this act" or "subject to the provisions of this Act". On the other hand, Section 424 uses the expression "under this Act". Hence, Section 433 of the Companies Act applies to the NCLT even when it decides applications under Section 7 and 9 of the Code.



Overriding Nature of the IBC

The Supreme Court, laying reliance on Section 238, has emphasised the overriding nature of the IBC over other laws, and anything inconsistent contained in any other enactment, in the case of *PR Commissioner of Income Tax Vs. Monnet Ispat and Energy Ltd*.

This has a significant impact on various legal actions under other statutes. For instance, in the case of *Raman Ispat Pvt. Ltd. Vs. Executive Engineer, Paschimanchal Vidyut Vitran Nigam Ltd*., the Allahabad Bench of NCLT set aside the order of the district collector regarding attachment of the property and prohibited the company from transferring the title through sale or donation. It held that state authorities or state-run utility providers cannot hinder the sale of land by a liquidator that they might have previously attached owing to unpaid dues of a distressed company.

Moratorium not to apply to assets of guarantors

In terms of Section 14 of the Code, upon admission of an application for initiation of corporate insolvency resolution process with respect to a corporate debtor, a moratorium is declared which *inter alia* prohibits (i) transferring, encumbering, alienation or disposing off assets of the corporate debtor and (ii) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property. Due to various conflicting rulings by the NCLT and the NCLAT on the subject matter, there was a lot of uncertainty regarding the scope of the moratorium i.e. whether the moratorium also covers assets of personal guarantors of the corporate debtor.

This issue was finally settled by the legislature with the passing of Insolvency and Bankruptcy Code (Amendment) Ordinance 2018 and consequently the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, specifically providing that the moratorium does not apply to a surety in a contract of guarantee of a corporate debtor. The Supreme Court in its order dated August 3, 2018 in the case of *State Bank of India* v. *V. Ramakrishnan & Anr.* has recently further clarified that the said amendment to the Code is retrospective in nature.

Moratorium does not cover any criminal proceedings

Another matter of ambiguity regarding the scope of the moratorium in terms of Section 14 of the Code was whether criminal proceedings are covered within the scope of the moratorium. In terms of Section 14 of the Code, upon admission of an application for initiation of corporate insolvency resolution process with respect to a corporate debtor, a moratorium is declared which *inter alia* prohibits the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree of order in any court of law.

The NCLAT in its order dated July 31, 2018 in the case of *Shah Brothers Ispat Pvt. Ltd.* v. *P. Mohanraj & Ors*. has now clarified that the order of moratorium under Section 14 of the Code will not cover a criminal proceeding under Section 138 of the Negotiable Instruments Act, 1881, (Act) and that Section 138 of Act is a penal provision which empowers the court to pass an order of imprisonment or fine which cannot be held to be a proceeding or a judgement or decree of money claim. The NCLAT has further held that no criminal proceeding is covered under Section 14 of the Code.

Home buyers to be treated as financial creditors

With the passage of the Insolvency and Bankruptcy Code (Amendment) Ordinance 2018 and consequently the Insolvency and Bankruptcy Code (Second Amendment)

Act, 2018, a long standing issue has been put to rest – the status of home buyers in case of debt stressed builders. The position of home /flat buyers had been in debate in the recent past at different forums, and there was no clarity on the status of home buyers.

Owing to the unique nature of financing in real estate projects, homebuyers have now been recognized as financial creditors under the Code. This amendment has been carried out keeping in mind the peculiarity of under construction apartments in India where a large number of the projects face various delays causing suffering to home buyers.

Since the monies raised by home buyers are a means of raising finance for construction, it has been decided to treat homebuyers as financial creditors by amending the definition of the term "financial debt" and including the following explanation to Section 5(8)(f) of the Code: "*any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing*". With this amendment, aggrieved home buyers have the ability to initiate insolvency proceedings against builders and also have the right of representation on the committee of creditors.

This inclusion has been a key marker of the Code's commitment to protect interests of various stakeholders. In light of the amendment, the Supreme Court ordered homebuyers to be included in the Committee of Creditors of Jaypee Infratech Limited, in the case of *Chitra Sharma vs. Union of India*. However, the question of whether they are secured or unsecured creditors continues to be a grey area.

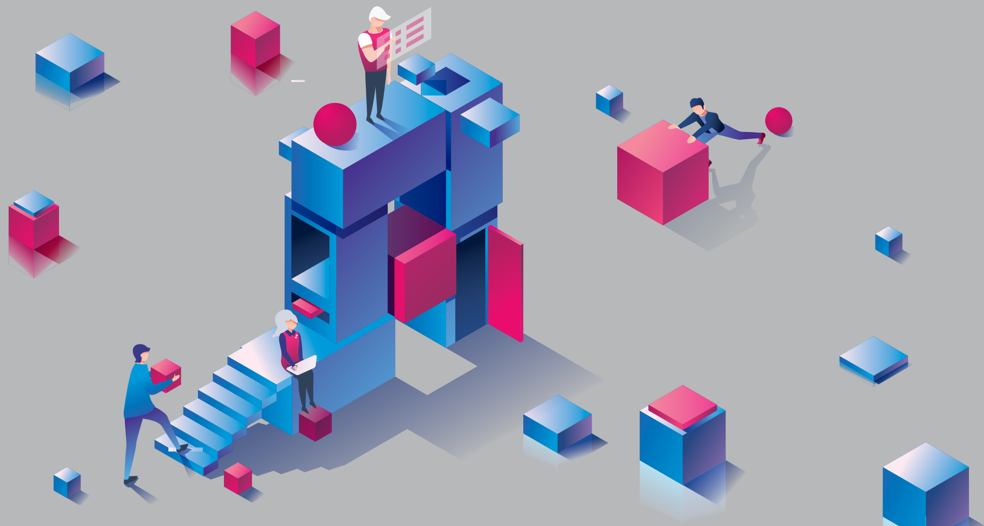
Beneficiary of an un-invoked guarantee to be given a seat at the committee of creditors

A question that has been raised time and again is whether a creditor being a beneficiary of an un-invoked corporate guarantee is a financial creditor or not, and similarly, whether a creditor which has issued a bank guarantee at the instance of a corporate debtor (being un-invoked) is a financial creditor or not.

The view which was prevalent was that a corporate debtor at whose instance a bank guarantee had been issued by a creditor to a beneficiary, would have repayment obligations towards the creditor in the event the guarantee is invoked and the creditor makes a payment thereunder. Similarly, in cases where a corporate guarantee had been issued at the instance of the corporate debtor in favour of a creditor, the corporate guarantor would have repayment obligations towards the creditor in the event of a default by the corporate debtor. Therefore, a future right to payment accrues to the creditor (as guarantor in case of a bank guarantee and as beneficiary in case of a corporate guarantee).

In terms of the definition of 'claim' in terms of Section 3 (6) of the Code, a right to payment, whether or not such right is fixed is treated as a 'claim'. Considering the guarantee had not been invoked, the creditor (as guarantor in case of a bank guarantee and as beneficiary in case of a corporate guarantee) would have an un-matured right to payment i.e. a claim, as on date, which can be filed with the interim resolution professional/ resolution professional.

In this regard, pursuant to a recent judgement of the NCLAT in the case of *Andhra Bank* vs. *M/s F.M. Hammerle Textile Limited* and *Axis Bank Limited* v. *Edu Smart Services Private Limited & Anr.*, the NCLAT has held that it is not necessary that all the claims submitted by a creditor should be claims matured on the insolvency commencement date or the guarantees be invoked. Even in respect of a future debt, a creditor can file a claim. The maturity of claim or default of claim or invocation of guarantee for claiming the amount has no nexus with filing of claim. If it is shown that the debt has been



disbursed against 'consideration for time value of money' then it is to be treated to be a financial debt, which may include debt as mentioned in clause (a) to (i) of Section 5 (8) of the Code. A counter-indemnity obligation in respect of a guarantee, given by a borrower to a creditor comes within the meaning of 'Financial Debt' in terms of Section 5 (7) and (8) of the Code.

Therefore, a repayment/ payment obligation being akin to the counter-indemnity obligations under the cases mentioned above, can be argued to be financial debt and accordingly, the creditor (as guarantor in case of a bank guarantee and as beneficiary in case of a corporate guarantee) can be argued to be a financial creditor of (i) the entity at whose instance the bank guarantee was issued by the creditor; and (ii) the entity who has issued the corporate guarantee in favour of the creditor.

That said, a reference may be made to the definition of 'voting share' in terms of Section 5 (28) of the Code which reads as "*the share of the voting right of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor*". As may be noted, the voting rights of a financial creditor at a meeting of the committee of creditors depends on the financial debt owing to the financial creditor. Therefore, in case of a creditor (as guarantor in case of a bank guarantee and as beneficiary in case of a corporate guarantee), while based on the NCLAT decision, the creditor's claim qualifies as a financial debt, the same is not currently owing to creditor (unless the guarantee has been invoked). Therefore, an argument may be taken that the creditor shall not be entitled to voting share based on these un-invoked guarantees. While the NCLAT did not dwell completely into the question of voting rights, the NCLAT did mention that the guarantor would not have the right to object to the resolution plan unless the objection is based on non-compliance with Section 30 (2) of the Code, thereby hinting towards such an argument.

Role of Suspended Directors in Committee of Creditors

The NCLT Mumbai bench, vide its judgment in the case of *Vijay Kumar Jain Vs. Resolution Professional, Committee of Creditors (In the matter of Standard Chartered Bank, DBS Bank v/s Ruchi Soya India Ltd* has addressed the question of whether a suspended director of a corporate debtor is entitled to confidential information in possession of the RP and CoC.

The NCLT held that if the information is confidential, the CoC could keep it to itself to maximise the valuation of assets of the company. The IBC shifts management from the Board to the CoC so that they can act prudently as to how to go about realising their dues from the corporate debtor. Relying on Regulations 21 and 24 of the CIRP Regulations, the tribunal said that the copies of all relevant documents have to be provided to all participants. As per Regulation 35 of the CIRP Regulations, the RP shall provide fair value and liquidation value to every member of the CoC in electronic form on receiving a confidentiality undertaking from the member. Suspended directors or any other person other than the CoC are not members, but participants. Hence, they are only entitled to copies of relevant documents provided to all participants and not to confidential information relating to fair value and liquidation value

Change in voting percentages

Under the Code, all decisions have to be taken by the requisite majority of the members of the committee of creditors based on their voting share. This threshold for approving decisions was initially 75% of the voting share for all decisions. Such a high threshold was increasingly becoming an impediment for effective decision making in the committee of creditors. Effectively, as a result of

the high threshold, blocking the resolution plan and other decisions of the committee of creditors, was easier than approving these.

In order to resolve this problem, the voting threshold has been reduced from 75% to 66% for all major decisions such as approval of resolution plan, extension of corporate insolvency resolution process period etc. Further, the voting thresholds for routine decisions has been reduced to 51%.

Section 29A

Section 29A is probably the most critical and highly debated provision of the Code. The section sought to restrict people who with their conduct contributed to defaults of companies or who were otherwise undesirable, to participate in the resolution process and regain control of the corporate debtor. However, the intent was somehow lost as the net of section 29A became too wide to intertwine even remotely associated entities; thus narrowing the path of resolution for the corporate debtor.

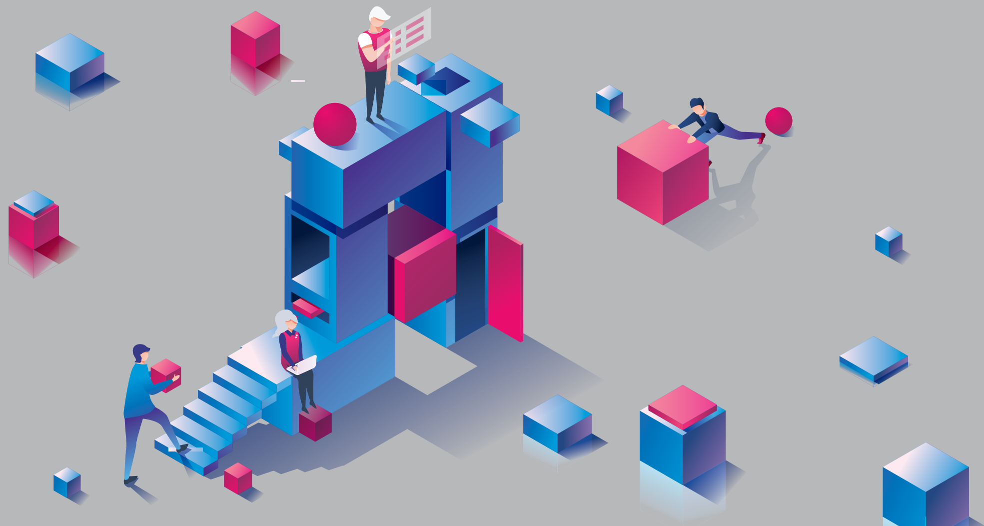
In order to address the problem of unintended exclusions under Section 29A, amendments have been brought about by the Insolvency and Bankruptcy Code (Amendment) Ordinance 2018 and consequently the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 so that only those who contributed to defaults of the company or are otherwise undesirable are rendered ineligible. Moreover, being mindful of the non-performing assets ("**NPA**") crisis in the country, the need to encourage the market for NPAs was felt and accordingly several carve-outs from Section 29A have been made for pure play financial entities. The amendments will help in broad basing the prospective resolution applicants and ensuring a better resolution of accounts.
Further, with a view to provide reliefs to MSMEs from the provisions of Section 29A of the Code, Section 240B has been inserted in the Code which specifically exempts resolution applicants for MSMEs that are undergoing corporate insolvency resolution process from certain eligibility criteria stated in Section 29A except the requirement that they should not be classified as wilful defaulters.

Interpretation of Section 29A

The Hon'ble Supreme Court, in the matter of *ArcelorMittal India Private Limited Vs. Satish Kumar Gupta,* laid to rest the issues surrounding interpretation of Section 29A, which are briefed below.

The opening lines of Section 29A refer to a *de facto* position as against a *de jure* position of the persons mentioned, and is a typical example of a "see through provision", so as to ascertain persons who are actually in control, whether jointly, or in concert with, other persons. It is an exception to the general principle of separateness of the company and its shareholders, and seeks to lift the corporate veil. Further, this principle is applied even to group companies, so that one is able to look at the economic entity of the group as a whole.

Section 29A uses the expression "under the management or control of such person". The word "under" indicates only positive or proactive control, as opposed to negative or reactive control, which means that the mere power to block special resolutions of a company cannot amount to control. Management refers to *de jure* management of a corporate debtor, which ordinarily vests in a Board of Directors, and would include in accordance with the definitions of "*manager*", "*managing director*" and "*officer*" in Sections 2(53), 2(54) and 2(59) respectively of the Companies Act, 2013, the persons mentioned therein. As per the definition of "control" in Section 2(27) of Companies Act, 2013, control refers to *de jure* as well



as *de facto* control. *De jure* control includes the right to appoint a majority of the directors of a company, while *de facto* control means, directly or indirectly, to positively influence in any manner, management or policy decisions. So long as management or policy decisions can be, or are in fact, taken by virtue of shareholding, management rights, shareholders agreements, voting agreements or otherwise, control can be said to exist.

The apex court also clarified that that the opening words of the section are “a person shall not be eligible to submit a resolution plan” which indicates that the stage of ineligibility attaches when the resolution plan is submitted by a resolution applicant. Sub-clause (c) uses the word “has” which is *in praesenti*, and needs to be contrasted with the expression “has been” used in sub-clauses (d) and (g). The 2018 amendment introducing the words “at the time of submission of the resolution plan” is clarificatory. Despite the fact that the relevant time for the ineligibility under sub-clause (c) to attach is the time of submission of the resolution plan, antecedent facts reasonably proximate to this point of time can always be seen, to determine whether the persons referred to in Section 29A are, in substance, seeking to avoid the consequences of the proviso to sub-clause (c) before submitting a resolution plan. If it is shown, on facts, that, at a reasonably proximate point of time before the submission of the resolution plan, the affairs of the persons referred to in Section 29A are so arranged, as to avoid paying off the debts of the non-performing asset concerned, such persons must be held to be ineligible to submit a resolution plan.

The judgment further clarifies that it is only the Adjudicating Authority (as defined under the Code) `which considers the approved plan and makes a quasi-judicial determination regarding the lawfulness of the plan. NCLT is not invested with the jurisdiction to interfere at an applicant’s behest at a stage before the quasi-judicial determination is done by the NCLT.

During the resolution process, the Resolution Professional is required to examine that the resolution plan submitted by various applicants is complete in all respects, before submitting it to the Committee of Creditors. He is not required to take any decision, but merely to ensure that the resolution plans submitted are complete in all respects before they are placed before the Committee of Creditors, who may or may not approve it. His *prima facie* opinion is to be given to the Committee of Creditors that a law has or has not been contravened. Section 30(2)(e) does not empower the Resolution Professional to decide whether the resolution plan does or does not contravene the provisions of law.

Resolution Plans Should not be Discriminatory and Should Seek to Maximise Assets

The NCLAT has addressed various questions relating to fairness of resolution plan in its judgment in the case of *Binani Industries Limited Vs. Bank of Baroda*. It held that the resolution plan submitted by Rajputana Properties Private Limited for Binani Cement was discriminatory and contrary to the scheme of the IBC as it prescribed differential treatment for similarly situated operational creditors or the financial creditors on one or other grounds, offered only liquidation value to dissenting creditors and the Committee of Creditors did not give due consideration to the revised plan submitted by Ultratech Cement Limited.

The appellate tribunal emphasised that the first order objective of IBC is “resolution”; the second order objective is “maximisation of value of assets of the Corporate Debtor” and thereby for all creditors, and not maximization of value for a stakeholder or a set of

stakeholders; and the third order objective is "promoting entrepreneurship, availability of credit and balancing the interests". This order of objective is sacrosanct.

It said that while only financial creditors are members of the Committee of Creditors, the liabilities of all creditors who are not part of the negotiation process must also be met in any negotiated solution. Both Financial Creditors and Operational Creditors are critical for businesses to run. It is possible to balance interests of all stakeholders if the resolution maximises the value of assets of the Corporate Debtor, and not when the resolution maximises the value for a stakeholder or a set of stakeholders such as Financial Creditors.

It further held that any resolution plan which provides liquidation value to the operational creditors or liquidation value to the dissenting financial creditors in view of clause (b) and (c) of Regulation 38(1), without any other reason to discriminate between two set of creditors similarly situated such as financial creditors or the operational creditors cannot be approved being illegal. Dissenting financial creditors cannot be discriminated on the basis of Regulation 38. Section 53, including explanation given therein cannot be relied upon while approving the resolution plan.

Approval of the Competition Commission

A concern that has been faced for some time was the lack of any provision in the Code on the approvals of the concerned regulators or authorities, if required, on the resolution plan prior to the resolution plan being approved by the NCLT. This was resulting in several conditional resolution plans being approved by the NCLT, which would also create a doubt over quick implementation of the resolution plan. One such regulator whose approval is invariably prescribed as a condition to the effectiveness of resolution plans was the Competition Commission of India ("**CCI**"). Under the Competition Act, 2002, an acquirer's obligation to notify the CCI is triggered upon execution of a binding document conveying an agreement or even a decision taken by the acquirer to acquire control, shares, voting rights or assets.

In this context, one of the earliest uncertainties was as to what would constitute a binding document for a prospective buyer to notify the CCI i.e. whether the submission of the resolution plan or the approval of such resolution plan by the committee of creditors. In many cases, the CCI approval was being sought after the approval of the resolution plan by the NCLT. This would result in delays in implementation of the resolution plan. Another potential concern would be that in the event CCI approval was not granted, the corporate debtor would face liquidation for non-implementation of the plan.

The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 has sought to address this issue by specifically providing that the approval of the CCI shall be required to be obtained prior to approval of a resolution plan by the committee of creditors. This ensures that the resolution plan will be in a position to be implemented after approval by the NCLT and there are no delays on implementation of the resolution plans or uncertainty regarding the CCI approval. The CCI has also been supporting the processes and there have been cases where CCI has granted approval within 15-20 days, which is noteworthy.

Regulatory Developments

IBBI (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2018

Due to the experience in some of the cases under the Code, a lot of doubt has been created on the sanctity of the process for inviting resolution plans, evaluation of the resolution plans and finally selecting a suitable resolution applicant. In certain cases, resolution plans have been received after the prescribed date for submission of resolution plans which were allowed by the committee of creditors. In certain cases, the NCLT has also ordered re-submission of resolution plans keeping in mind the principle of maximization of value of assets of corporate debtor.

With the passage of the IBBI (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2018, this entire process has been clearly defined and now resolution professionals have a broad framework set out for their reference. This has helped in creating a more certain and structured process and further streamlined the resolution of stressed accounts.

In terms of the revised CIRP Regulations, the resolution professional shall publish an invitation for expression of interest ("**EoI**") by the 75th day from the insolvency commencement date. The invitation shall specify the criteria, ineligibility, the last date for submission of EoI and other details and shall not require payment of non-refundable deposit. Any EoI received after the specified time shall be rejected. The resolution professional shall conduct due diligence based on material on record and issue a provisional list of prospective resolution applicants within 10 days of the last date of submission of EoI. On considering objections to the provisional list, the resolution professional shall issue the final list of prospective resolution applicants, within 10 days of the last date for receipt of objections. The resolution professional shall issue the information memorandum, the evaluation matrix and the request for resolution plans ("**RFRP**"), within five days of issue of the provisional list to the prospective resolution applicants and allow at least 30 days for submission of resolution plans. The RFRP shall detail each step in the process, and the manner and purposes of interaction between the resolution professional and the prospective resolution applicant, along with corresponding timelines.

IBBI (Insolvency Resolution Process for Corporate Persons) (Fourth Amendment) Regulations, 2018

The CIRP Regulations earlier required the resolution professional to circulate the minutes of the meeting by electronic means to all members of the committee of creditors within forty-eight hours of the conclusion of the meeting and to seek a vote of the members who did not vote at the meeting. The amendment now requires the resolution professional to circulate the minutes of the meeting by electronic means to authorized representative(s) also. It further requires the authorized representative to circulate the minutes of the meeting received from the resolution professional to the financial creditors in a class. He shall announce the voting window at least twenty-four hours before the window opens for voting instructions and keep the voting window open for at least twelve hours. He shall exercise the votes either by electronic means or through electronic voting system as per the voting instructions received by him from the financial creditors in the class pursuant to circulation of the minutes. This will enable a financial creditor in a class, who could not vote on a matter before the meeting, to vote after minutes of the meeting are circulated.

The Regulations earlier provided payment of liquidation value to operational creditors and dissenting financial creditors in priority. The amendment has substituted the said regulations to provide that the amount due to operational creditors under the resolution plan shall be paid in priority over financial creditors. Consequently,

reference to dissenting financial creditors has been deleted from the CIRP Regulations. The regulations mandate the resolution professional to preserve the physical and electronic copy of the records relating to insolvency resolution process of the corporate debtor as per the record retention schedule.

IBBI (Insolvency Professional Agencies) Amendment) Regulations, 2018 and IBBI (Information Utilities) (Second Amendment) Regulations, 2018

The Insolvency Professionals Agencies (IPAs) Regulations have been amended to the effect that no person can directly or indirectly, either individually or together with persons acting in concert, acquire or hold more than 5% of the paid-up equity share capital in an insolvency professional agency (IPA). However, certain entities, as listed in the exceptions, have been permitted to hold up to 15% of the paid-up equity share capital. Central/ state government and statutory regulator can hold up to 100% of the paid up equity share capital. Amendments similar to IPAs have been made in respect of information utilities too.

IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) (Amendment) Regulations, 2018

The amended regulations provide for composition of the Governing Board of an Insolvency Professional Agency and its managing director. The Governing Board shall consist of managing director, independent directors and shareholder directors, wherein the Managing Director will not be considered either independent or shareholder director. An individual may serve as an independent director for a maximum of 2 terms of 3 years each or part thereof, or up to the age of 70 years, whichever is earlier. The appointment, renewal of appointment and termination of service of the managing director shall be subject to prior approval of the IBBI. The managing director shall be an ex officio member of Membership Committee, Monitoring Committee, Grievance Redressal Committee and Disciplinary Committee.

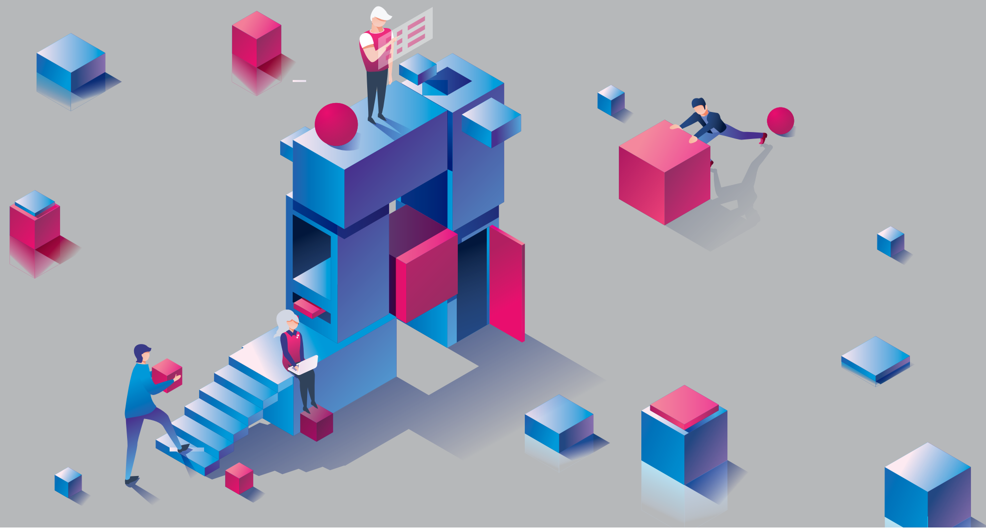
IBBI (Insolvency Professionals) (Second Amendment) Regulations, 2018

According to the amendments to the Insolvency Professionals (IPs) Regulations, an IP is to pay to the IBBI, a fee calculated at the rate of 0.25% of the professional fee earned for his services as an IP in the preceding financial year on or before the 30th of April every year. An eligible person seeking recognition as an IP entity shall pay an application fee of Rs. 50,000 along with the application for recognition. An IP entity shall pay to the IBBI, a fee calculated at the rate of 0.25% of the turnover from the services rendered by it in the preceding financial year, on or before the 30th of April every year. An IP entity shall inform the IBBI, within 7 days, when an individual ceases or joins as its director or partner, as the case may be, along with a fee of Rs. 2000. Delay in payment of fee by an IP or an IP entity will attract a simple interest at the rate of 12% per annum on the amount of fee unpaid, without prejudice to any other action which the Board may take.

IBBI (Liquidation Process) (Second Amendment) Regulations, 2018

Under the Liquidation Regulations, Regulation 32 (Manner of Sale; now Sale of Assets etc.) of has been amended to enable the liquidator to sell *inter alia* the business(es) of the corporate debtor as a going concern. A proviso has been added stating that where an asset is subject to security interest, it shall not be sold under any of the methods mentioned under 32 unless the security interest therein has been relinquished to the liquidation estate

Regulation 34 (Asset memorandum), sub-regulation (2)(b) (details in respect of assets which are intended to be realised by way of sale) has been amended to



replace "value of set of assets or assets in parcels or assets in a slump sale, as the case may be, valued in accordance with Regulation 35, if intended to be sold as specified in Regulation 32(b)" with "value of the assets or business(s) under clauses (b) to (f) of regulation 32, valued in accordance with regulation 35, if intended to be sold under those clauses;".

Regulation 35 (Valuation of assets intended to be sold) has been replaced to the effect that valuation conducted under CIRP regulations and under the IBBI (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017 is to be averaged for the purpose of valuation under Liquidation Regulations. If those valuations are not conducted, then the amended Regulation 35 provides a separate mechanism, with certain restrictions on appointment of valuers. Lastly, under Schedule II, Form B for public announcement has some minor amendments made to it.

IBBI (Mechanism for Issuing Regulations) Regulations, 2018 (Issuing Regulations)

IBBI has created a landmark by issuing the process it would follow while issuing regulations which is unprecedented in India. Section 240 of the IBC empowers the IBBI to make regulations subject to certain conditions. Section 196 (1)(s) requires the IBBI to specify mechanisms for issuing regulations, including the conduct of public consultation processes, before notification of regulations. The Issuing Regulations have been notified to govern the process of making regulations and consulting the public.

The Issuing Regulations provide that for the purpose of making or amending any regulations, the IBBI shall upload the following, with the approval of the Governing Board, on its website seeking comments from the public- draft of proposed regulations, the specific provision of the Code under which the Board proposes regulations, a statement of the problem that the proposed regulation seeks to address, an economic analysis of the proposed regulations, a statement carrying norms advocated by international standard setting agencies and the international best practices, if any, relevant to the proposed regulation, the manner of implementation of the proposed regulations and the manner, process and timelines for receiving comments from the public.

The IBBI shall allow at least twenty-one days for public to submit their comments. It shall upload the same on its website along with a general statement of its response on the comments. If the Governing Board decides to approve regulations in a form substantially different from the proposed regulations, it shall repeat the process under the Issuing Regulations.

IBBI's Circular on Valuation under the Insolvency and Bankruptcy Code

The Companies (Registered Valuers and Valuation) Rules, 2017 notified under the Companies Act, 2013 provides a comprehensive framework for development and regulation of the profession of valuers. The IBBI performs the functions of the Authority under the Companies (Registered Valuers and Valuation) Rules, 2017. It conducts valuation examinations for all three asset classes, namely, Land and Building, Plant and Machinery, and Securities or Financial Assets. It also recognises RVOs and registers valuers. The regulations specify requirements of valuation and who can conduct such valuation. Every valuation required under the Code or any of the regulations made thereunder is required to be conducted by a 'registered valuer', that is, a valuer registered with the IBBI under the Companies (Registered Valuers and Valuation) Rules, 2017. Vide the circular No. IBBI/RV/019/2018, with effect from 1st February, 2019, no insolvency professional shall appoint a person other than a registered valuer to conduct any valuation under the Code or any of the regulations made thereunder.

SEBI Regulations

While the introduction of the Code was a welcome move by the Government, a holistic approach by amending the Securities and Exchange Board of India ("**SEBI**") regulations for seamless process and compliance was lacking. A spate of amendments by the SEBI in regulations such as the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**SEBI Takeover Regulations**"), the SEBI Issue of Capital and Disclosure Requirements Regulations, 2009 ("**SEBI (ICDR) Regulations**") and SEBI (Delisting of Equity Shares) (Amendment) Regulations, 2018 have served as a bridge between the Code and the respective SEBI regulations to further smoothen and streamline the insolvency resolution process.

In relation to open offer requirements of the existing SEBI Takeover Regulations under Regulation 3, the proviso to sub regulation (2) does not permit acquisitions that would breach the maximum permissible non-public shareholding limit of 75%. After the said proviso, another proviso has now been inserted enabling the successful acquirer under the Code to hold more than 75% in a listed entity. A similar amendment in Rule 19A of Securities Contract Regulation Rules, 1957 is required for granting the full benefit of the above amendment.

SEBI had in August 2017, exempted listed entities whose resolution plan had been approved under the Code from complying with the requirements of preferential issue of equity shares. The said relaxation has now been extended to preferential issue of convertible securities as well. However, provisions in relation to lock-in of securities would continue to apply.

The SEBI (Delisting of Equity Shares) (Amendment) Regulations, 2018, exempts listed entities whose resolution plan has been approved under the Code from complying with procedures, if the resolution plan: Lays down any specific procedure to complete the delisting of such shares; or Provides an exit option to existing public shareholders at a price specified therein. It further provides that exit to shareholders of such listed entities should be at a price not less than the liquidation value, as determined under Regulation 35 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, after paying off dues in the order of priority, as defined under Section 53 of the Code.

Other Developments of Note

Report of the Insolvency Law Committee on Cross-Border Insolvency, October 16, 2018

In its first report submitted in March 2018, the Insolvency Law Committee noted that the existing provisions in the Code (sections 234 and 235) do not provide a comprehensive framework for cross-border insolvency matters. In its second report, the Committee has sought to provide the same based on the UNCITRAL Model Law on Cross-Border Insolvency, 1997 which could be made a part of the Code by inserting a separate part for this purpose. As Part III of the Code that deals with insolvency resolution and bankruptcy for individuals and partnership firms has not been notified yet, the Committee recommends application of cross-border insolvency provisions to corporate debtors to start with and based on the experience gained, it could be extended to individual insolvency in due course of time. Similar approach has been followed in Singapore and some other countries.

Four main principles on which the Model Law is based are: access (allowing foreign insolvency professionals and foreign creditors direct access to domestic courts), recognition (of foreign proceedings and provision of remedies by domestic courts), cooperation (basic framework for cooperation between domestic and foreign courts and domestic and foreign insolvency professionals), and coordination (of two or more concurrent insolvency proceedings in different countries by encouraging cooperation between courts).

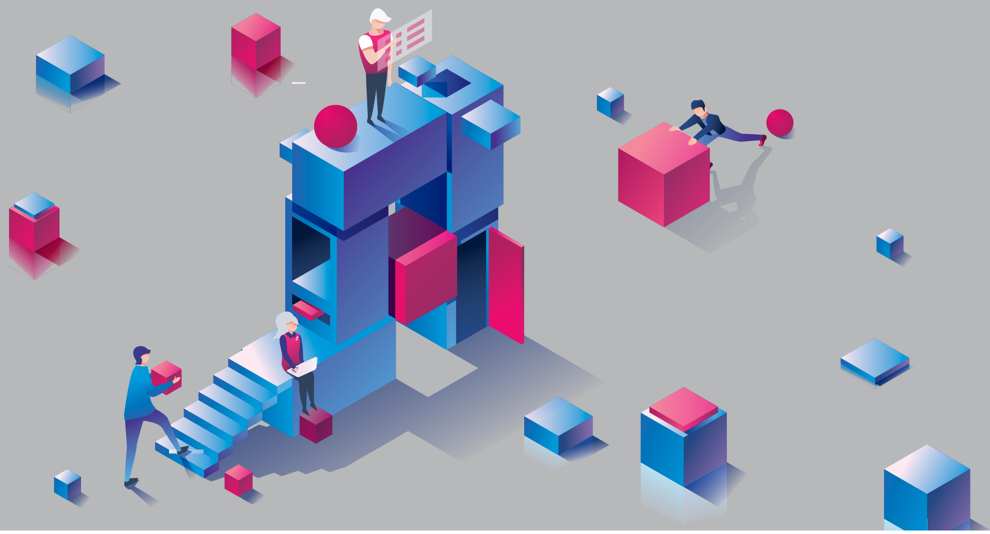
The Committee has indicated some key advantages of adopting the Model Law: increase in foreign investment, flexibility, protection of domestic interests, priority to domestic proceedings and mechanism for cooperation of recommendations will create an internationally aligned and comprehensive insolvency framework for corporate debtors. However, issues such as treatment of insolvency of enterprise groups will still remain a challenge, as the proposed framework is meant for individual companies and not enterprise groups.

RBI's Revised Framework on Resolution of Stressed Assets

The RBI's Revised Framework on Resolution of Stressed Assets was issued vide its circular dated February 12, 2018 (Circular). It seeks to harmonise existing guidelines with norms specified in the IBC for resolution of stressed assets. The Circular has repealed all earlier restructuring schemes (CDR, JLF, SDR, S4A, flexible restructuring) and the lenders are required to develop board-approved policies for resolution of stressed assets under this framework.

For existing defaults, where resolution plan aggregate exposure is greater than Rs. 20 billion, a resolution plan has to be finalized within 180 days from March 1, 2018. All cases where earlier schemes of RBI were invoked but not implemented are to fall under the revised framework. If the implementation of the resolution plan fails during specified period, lenders are to take the borrower to the IBC process.

The Circular created great unrest in certain sectors, especially the power sector. Writ petitions were filed in various courts, but the case from Allahabad High Court is of note (*Independent Power Producers Association of India Vs. Union of India*). The court held that the February 12 circular is valid under Section 35 AB of the Banking Regulation Act. There is a distinction between Section 35AA and 35BB, which is that under Section 35AB, directions given by RBI are general in nature and not to initiate action under IBC, and do not require authorisation by the central government. The circular is not sector specific, and hence does not fall under Section 35AA. The court shall not interfere in matters of economic policy and shall exercise judicial self-restraint, while leaving the matter to the expert wisdom of the RBI. If the central government deems it fit, it can initiate the consultative process with RBI under Section 7 of the RBI Act, in light of its interest in revival of stressed power plants. RBI itself is not expected to take sector-specific



view and is responsible for taking a macroeconomic view. Given the directions in the circular, banks do not have the discretion to not invoke IBC, notwithstanding a direction of the RBI. No interim relief was granted.

On appeal, the Supreme Court, in the matter of *Reserve Bank of India Vs. Dharani Sugars and Chemicals Ltd,* has allowed the transfer of writ petitions pending before Madras High Court, Gujarat High Court, Allahabad High Court and Delhi High Court, all relating to RBI's February 12th circular. It has ordered status quo pertaining to the transfer petition and pending writ petitions. Lenders will still be able to approach the NCLT

Conclusion

While the three arms of the government as well as other stakeholders are relentlessly striving to make the Code functional and ensure speedy resolution of stressed assets, there are some bottlenecks which need to be resolved. While Section 31 of the Code makes the resolution plan binding on stakeholders, there is no guidance provided on third party approvals, particularly from other regulators. With the recent amendments, homebuyers have been identified as financial creditors, but their status as secured or unsecured is not clear. In the same vein, the Code does not clarify how differential charges held over assets are to be dealt with, which becomes significant in the waterfall mechanism under Section 53 of the Code. There are issues pertaining to fairness of resolution plans giving liquidation value to operational creditors which remain unaddressed.

Despite these shortcomings, the Insolvency and Bankruptcy Code is a hallmark of the economy trying to rejuvenate itself. The level of activity by the three arms of the government is unprecedented. India's improvement in global rankings and credit ratings is a testimony to the changing landscape of economy. The Code is expected to further strengthen the process of resolution of stressed assets, and with the pace of developments discussed in this piece, the process can be expected to be nothing short of promising.

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