RECENT TRENDS AND LITIGATION CHALLENGES AROUND INSOLVENCY & BANKRUPTCY CODE, 2016

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Insolvency and Bankruptcy Code, 2016 ("Code") has been implemented with a view to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals, in a time bound manner, for maximization of value of assets of such persons. The Code is intended to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders in accordance with its preamble.

Recent Trends

The situation of non-performing assets ("NPA")/ stressed assets in the country is not unknown. NPAs essentially mean the loans which the borrowers have defaulted on, beyond a period of 90 days. As per the available records, the stressed assets for public sector banks is the highest at 17%, for the private banks at 7% and for foreign lenders it is about 6%. The majority of the stressed assets are lying in infrastructure, steel and textile sector.

In view of the over looming problem of the stressed assets and the figures running into several crores of rupees as well as for the purpose of tackling the issue of NPAs effectively, the President of India promulgated Banking Regulation Ordinance on May 05, 2017 ("Ordinance") to bring amendment to the Banking Regulation Act, 1949. Pursuant to the Ordinance, two new provisions viz. Section 35AA and Section 35AB were inserted under the Banking Regulations Act, 1949.

By way of Section 35AA of the Banking Regulation Act, 1949, the Central Government has been empowered to authorize the Reserve Bank of India (the "RBI") to issue any direction(s) to banking companies, to initiate insolvency resolution process against the borrower, who has committed a default under the Code. Further, Section 35AB inter-alia authorizes RBI to issue directions to banking companies at its own for resolution of stressed assets.

In exercise of its power under Section 35AA and Section 35AB of the Banking Regulation Act, 1949, the RBI came out with a press release dated May 22, 2017 read with another press release dated June 13, 2017, modified by corrigendum dated July 08, 2017, inter-alia outlining the action plan in relation to implementation of Banking Regulation (Amendment) Ordinance, 2017. Pursuant thereto, top 500 accounts of the banking system having highest exposure and converted into NPAs, whether wholly or partly, were considered for review and 12 largest defaulters having 25% of the total gross NPAs were referred to NCLT for actions under the Code.

Litigation Challenges

The Code has witnessed and is still witnessing several challenges in regards to the interpretation of its material aspects before the adjudicating authority (NCLT) and the appellate authority (NCLAT). Numerous orders have been passed by the NCLT, which have been impugned before the NCLAT and the NCLAT has settled the position in regards to the interpretation. Even, the orders of NCLAT are also being appealed before the Supreme Court of India. We have highlighted a few of the important orders:

In the matter of "Innoventive Industries Ltd Vs ICICI Bank and Another ", the NCLAT after taking into consideration the decision of the Hon'ble Supreme Court, the provisions of Code and rules framed thereunder has held that Section 424 of the Companies Act, 2013 is applicable to the proceeding under the Code, hence it is mandatory for the NCLT to follow the principles of rules of natural justice while passing an order under the Code. Thus, the NCLT is required to take into consideration the contentions of the corporate

debtor.

In the matter of "Kirusa Software Private Limited Vs Mobilox Innovations Private Limited ", the NCLAT has settled the issue of interpretation of the word 'dispute' appearing under the Code in relation to the operational creditor and thus put to rest the controversy that had arisen due to the conflicting orders passed by various NCLTs.

The NCLAT has ruled that the terms "dispute" would not only cover "pending proceedings or "lies, within the limited ambit of suit or arbitration proceedings" or other legal proceedings initiated but also include where there are bonafide disputes between the parties in relation to the operational debt. Thus, the bonafide disputes must not necessarily be dispute which are either initiated or filed before an appropriate court/tribunal but would include where parties in their correspondence or otherwise prima facie show existence of genuine dispute.

To sum up the impact of the aforesaid order, in cases where there are genuine dispute(s) between the parties, before issuance of the demand notice, which could be in relation to (i) existence of amount of the debt, (ii) quality of good or service, and (iii) breach of a representation or warranty, the operational creditor may not be able to sustain its case against the corporate debtor under the Code. That said, the operational creditor is not remediless but has the right to file a case before the appropriate court/tribunal.

In the matter of "Now floats Technologies Private Limited Vs. Get it Info services Private Limited ", the NCLT, Delhi has held that when a winding up petition is pending before the concerned High Court and any provisional liquidator/official liquidator is appointed, the insolvency resolution process against such corporate debtor cannot be admitted. This was based on the premise that continuation of both the processes i.e. liquidation under the Companies Act, 2013 and insolvency resolution shall amount to collusive course of action.

Recently, in the matter of "Lokhandwala Kataria Construction Private Limited versus Nisus Finance and Investment Manager LLP ", the Hon'ble Apex Court by exercising its discretionary powers under Article 142 of the Constitution of India, inter-alia, accepted the consent terms on its record.

The corporate debtor, post admission of the insolvency petition by the NCLT, filed an appeal before the NCLAT impugning the order passed by the NCLT. Before the NCLAT, it was urged that since the disputes between the parties were settled, the admission order passed against the corporate debtor by the NCLT must be set aside. The NCLAT observed that such settlement cannot be a ground to interfere with the order passed by the NCLT and thus dismissed the appeal.

The appellant approached the Hon'ble Supreme Court in appeal and the Apex Court concurred with the view of the NCLAT that the inherent powers of the NCLT under the NCLT Rules, 2016 could not be utilised for the purpose of the Code, though it exercised its discretionary powers under Article 142 of the Constitution of India and, inter-alia, accepted the consent terms on its record.

Deem Roll-Tech Limited versus M/s R.L. Steel & Energy Limited - In this matter, NCLT (Delhi) dismissed an application of the operational creditor, inter alia, on the ground that the claim was barred under the law of limitation. Thus, ruling that the Limitation Act, 1963, would also be applicable for an insolvency proceeding against a corporate debtor.

In the case of Schweitzer Systemtek India Private Limited Vs. Phoenix ARC Private Limited , the NCLT, Mumbai while adjudicating a Section 10 application, filed by the corporate debtor itself, has held that a moratorium declared in terms of the Code is applicable to the corporate debtor and not to its promoters or guarantors. Thus, the moratorium would prohibit action against the properties of the corporate debtor, but not any

other properties beyond its ownership. Accordingly, it was clarified that the proceedings under the SARFAESI Act may continue against the promoters and/or the guarantors notwithstanding the insolvency resolution process commenced against the corporate debtor.

A question arose before the NCLAT in the matter of Macquarie Bank Limited Vs. Uttam Galva Metallics Limited whether a certificate from the financial institution maintaining account of the operational creditor confirming that there is no payment of unpaid operational debt, as provided under Section 9 (3) (c) of the Code, is mandatory. It was held by the NCLAT that entire provisions of the Section 9 (3) are required to be followed mandatorily. It was further held that since the appellant is not a financial institution in terms of Section 3 (14) of the Code, any certificate provided by Macquarie Bank Limited cannot be relied upon as an evidence to decide default of debt.

Conclusion

The trend seems to suggest that more than the financial creditors, the operational creditors are pursuing their legal recourse under the Code for realisation of their debts. However, with the recent Ordinance, the financial creditors seem to be taking cognisance of the Code.

In the absence of the settled jurisprudence in regards to the Code at the time of its implementation, there were several discrepancies in regards to (a) interpretation of the word 'dispute' for operational creditor; (b) the procedure/ manner to establish the default of the corporate debtor in the absence of information utility mechanism; (c) application of the principles of natural justice to the proceedings under the Code etc. However, with the passage of time, the NCLT, the NCLAT and the Supreme Court are endeavoring to put such controversies to rest. Thus, the tribunals and the Supreme Court are also playing an essential role in drawing the roadmap for the Code.

We, however, think that the Code may see further interpretational changes once the rules of procedure for the Code are framed. Part III of the Code which deals with insolvency resolution and bankruptcy for individuals and partnership firms is yet to be notified. The same is expected to be notified soon and it would be interesting to see how the insolvency and bankruptcy law for individuals and partnership firms evolve.