DEVELOPMENTS IN INSOLVENCY LAWS

IN APRIL 2019

ABOUT ACUITY LAW

Acuity Law was founded in November 2011. Acuity Law comprises of a team of young and energetic lawyers led by Souvik Ganguly and Gautam Narayan, who have deep and diverse experiences in their chosen areas of practice. We have advised Indian and multinational companies, funds, banks and financial institutions, founders of companies, management teams, international law firms, domestic and international investment banks, financial advisors and government agencies in various transactions in and outside India.

Acuity Law takes pride in rendering incisive legal advice taking into consideration commercial realities. Our areas of practice are divided into two departments.

The Corporate practice is led by Souvik Ganguly and the Disputes practice is led by Gautam Narayan.

As part of the Corporate practice, Acuity Law advises on:

- Mergers and acquisitions;
- Distressed mergers and acquisitions;
- Insolvency Law;
- Private Equity and Venture Funding;
- Employment and labour laws
- Commercial and trading arrangements; and
- Corporate Advisory

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- Civil disputes;
- Criminal law matters; and
- Arbitration matters

Acuity Law actively follows legislative and policy developments in its chosen areas of practice and shares such developments with clients and friends on a regular basis.

If you want to know more about Acuity Law, please visit our website www.acuitylaw.co.in or write to us at al@acuitylaw.co.in.

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INTRODUCTION

This newsletter covers key updates about the developments in the Insolvency law during the month of April 2019. We have summarized the key judgments passed by Hon'ble Supreme Court of India (SC), National Company Law Appellate Tribunal (NCLAT) and various benches of the National Company Law Tribunals (NCLT). Please see below the summary of the relevant regulatory developments and reports.

OPERATIONAL CREDITOR HAS A RIGHT TO PROSECUTE PENDING AMOUNTS THROUGH A RECOVERY SUIT AS RESOLUTION PLAN HAD APPROVED THE SAME

Matter: Tata Steel BSL Limited vs. Varsha and others

Order dated: 28 March 2019

Summary:

In this matter, State Bank of India being one of the main creditors of M/s. Bhushan Steel Limited filed an application under section 7 of the Insolvency and Bankruptcy Code, 2016 (Code) for initiation of corporate insolvency resolution process (CIRP) which got duly admitted. Pursuant to the same, Varsha (Respondent No. 1 / Original Plaintiff) submitted its claim to the RP of Bhushan Steel Limited. Subsequently, Tata Steel BSL Limited (Petitioner / Original Defendant), got declared the successful resolution applicant by getting its resolution plan approved by the Adjudicating Authority (AA). However, under the said plan, no amount was specifically stipulated which would be payable to operational creditors, one of them being Respondent No. 1.

In view of the same, the Original Plaintiff filed a suit before the Court of Joint Civil Judge, Senior Division, Nagpur (Trial Court) for the reason being that the said resolution plan itself provided for a specific identified fund for meeting the liability payable to operational creditors like the Original Plaintiff and that the said suit must reach its logical end for crystallizing the exact amount payable by the Original Defendant to Original Plaintiff. The Original Defendant filed an application for dismissing the said suit, however the Trial Court held that the proceedings undertaken as per the provisions of the

Code did not have the effect of extinguishing the right of Original Plaintiff to continue to prosecute the suit for recovery filed against erstwhile M/s. Bhushan Steel Limited and now the Original Defendant.

Hence, the question for consideration was whether Original Defendant was justified in contesting that upon process of CIRP being triggered under the Code and the Original Plaintiff having participated in the same, a suit for recovery of amount filed by respondent No.1 could no longer survive and that the Trial Court committed an error in rejecting the application filed by the Petitioner for dismissal of the suit.

In view of the above, the Petitioner filed a writ petition before the Bombay High Court challenging the order of the Trial Court. The High Court however upheld the order of the Trial Order.

The High Court held that Operational Creditor has a right to prosecute pending amounts through a recovery suit as the resolution plan which had attained finality reflected the amounts due to Operational Creditors such as that of the Respondent, and the same were to be paid on crystallization of the pending civil suit.

RBI CIRCULAR DATED 12 FEBRUARY 2018, WHEREIN RBI DIRECTED BANKS TO INITIATE PROCEEDINGS UNDER THE CODE WAS HELD TO BE ULTRA VIRES

Matter: Dharani Sugars and Chemicals Limited vs. Union of India and others

Order dated: 02 April 2019

Summary:

In this matter the SC struck down the Reserve Bank of India's (RBI) circular dated February 12 (RBI Circular) whereby RBI passed a revised framework for resolution of stressed assets. As per the circular every company in India that defaulted on loans with aggregate exposure of more than Rs. 2000 crore were to be given 180 days to resolve their defaults and if such companies could not resolve their defaults with their lenders within 180 days then the lenders were to move the NCLT under the IBC within 15 days from the expiry of the 180 days. It was the case of the Petitioners that the circular failed to distinguish willful defaulters and victims of circumstance. For instance, power companies faced issued on account of regulatory mismanagement being victims of circumstances.

Further, the RBI Circular was issued by RBI by exercising the power granted to it under section 35AA of the Banking Regulation Act, 1949 (Banking Regulation Act). As per section 35AA of the Banking Regulation Act which came into force on 04 May 2018 it is a prerequisite for RBI to obtain authorization from the Central Government to exercise its power under section 35AA.

Though RBI Circular was issued by the RBI in exercise of the power granted to it under Section 35AA, and with the consent of the Central Government; the SC held that the RBI did not comply with section 35AA and was therefore illegal. As per the SC, section 35AA of the Banking Regulation Act is not a general power and is to be exercised only to resolve specific cases of defaults. To buttress this, reference was drawn to the Press Note dated 05 May 2017 that introduced the Banking Regulation (Amendment) Ordinance, 2017 which introduced Sections 35AA and 35AB as amendments to the Banking Regulation Act which specifically referred to resolution of "specific" stressed assets which empowers RBI to intervene in "specific" cases of resolution of non-performing assets. Further, reference was also drawn to the Statement of Objects and Reasons that introduced Section 35AA which emphasizes that directions are in respect of "a default". Accordingly, the SC held that the RBI can act only with respect to 'specific cases' under the Section 35AA of the Banking Regulation Act.

ON WITHDRAWAL OF THE APPLICATION, THE COSTS INCURRED BY THE INTERIM RESOLUTION PROFESSIONAL (IRP) SHALL BE EQUALLY BORNE BY THE APPLICANT (CREDITOR) AND THE CORPORATE DEBTOR

Matter: Raju Verma vs. Kaushalya Ahluwalia and another

Order dated: 24 April 2019

Summary:

In this matter, the parties proposed to settle the case and pleaded to withdraw the same before the NCLAT. The NCLAT observed that the CoC had not been constituted and therefore allowed the withdrawal of the insolvency application.

Further, since the IRP had already incurred certain costs with respect to the Corporate Insolvency Resolution Process (CIRP), the NCLAT directed both the corporate debtor and the financial creditor (applicant) to share the relevant expense by bearing 50% of the costs, each.

Comment: Generally, the costs are entirely imposed on the applicant, however under this order, the NCLAT decided that the same should be shared equally between the corporate debtor and the applicant.

A TRADE UNION HAS THE RIGHT TO INITIATE INSOLVENCY PROCEEDING ON BEHALF OF WORKMEN UNDER THE CODE

Matter: JK Jute Mill Mazdoor Morcha vs. Juggilal Kamlapat Jute Mills Company Limited and others

Order dated: 30 April 2019
Summary:

In this matter, the SC dealt with an important issue as to whether a trade union could be said to be an operational creditor under the Code.
It is pertinent to note that, the NCLT and NCLAT had held that a trade union cannot be covered as an operational creditor under the Code. Further, the NCLAT stated that each worker will be required to file a separate insolvency application before the NCLT. Accordingly, an appeal was preferred against the said rulings before the SC by JK Jute Mill Mazdoor Morcha (being the trade union).

In view of the above, the SC observed that instead of one consolidated petition by a trade union representing a number of workmen, filing individual petitions would be burdensome as each workman would thereafter have to pay CIRP including costs of IRP, valuers, etc. under the provisions of the Code read with the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. Accordingly, there is no doubt that a registered trade union which is formed for the purpose of regulating the relations between workmen and their employer can maintain a petition as an operational creditor on behalf of its members.

Hence, the SC inter alia held that the NCLAT was incorrect in stating that a trade union would not be an operational creditor as no services are rendered by the trade union to the corporate debtor and thereby allowed the appeal.

INSOLVENCY PROCEEDING INITIATED UNDER THE CODE CANNOT BE CLASSIFIED AS A 'COERCIVE STEP' AGAINST THE CORPORATE DEBTOR

Matter: V Hotels Limited vs. Asset Reconstruction Company (India) Limited
Order dated: 01 May 2019

Summary:

In this matter, the V Hotels Limited (Corporate Debtor) filed an application wherein it had challenged the maintainability of the section 7 application filed before the NCLT, Mumbai Bench (NCLT) against it by Asset Reconstruction Company (India) Limited (Financial Creditor) in view of an order passed by the Hon'ble Bombay High Court (HC) in favour of the Corporate Debtor (HC Order).

Under the HC Order, the HC restrained the Financial Creditor from taking any 'coercive steps' against the Corporate Debtor subject to deposit of money by the Corporate Debtor.

The Corporate Debtor submitted that it deposited the relevant amount pursuant to the HC Order and accordingly prayed before the NCLT to dismiss the insolvency application as the same is 'coercive' in nature and hence it was wrong on part of the Financial Creditor to act in contravention to the HC Order.

In view of the above, the NCLT *inter alia* held that the HC Order should not be made applicable to the said insolvency proceeding due to the fact that mere filing of an insolvency application does not prejudice the Corporate Debtor as it is an efficacious remedy available to both the Financial Creditor as well as the Corporate Debtor, which is beneficial for both. Further, the Code is not a "coercive measure" for the Corporate Debtor but for the defaulting management. Hence, the application challenging the maintainability of the insolvency application was dismissed.

THE RIGHT TO 'SET OFF' IS RECOGNIZED UNDER THE CODE

Matter: Bharti Airtel Limited & Bharti Hexacom Limited vs. Vijaykumar V. Iyer
Order dated: 01 May 2019

Summary:

In this matter, Bharti Airtel Limited and Bharti Hexacom Limited (Airtel Entities) entered into a Spectrum Trading Arrangement (STA) with Aircel Limited and Dishnet Wireless Limited (Aircel Entities) for the transfer of right to use the Spectrum in the 2300 MHz band in favour of Airtel Entities. The approval of Department of Telecommunications (DoT) was required for implementing the STA.

Pursuant to the demand of bank guarantees by DoT, Aircel Entities approached Airtel Entities to submit the same on behalf of itself. Subsequently, Airtel Entities submitted bank guarantees of approx. INR 4537. 3 million to DoT on behalf of Aircel Entities.

Further, it is pertinent to note that, Aircel Entities also owed a total of INR 1393. 4 million to Airtel Entities pursuant to unpaid invoices under various service and inter-connection agreements

As, Aircel Entities was admitted under the insolvency process, simultaneously there was adverse consequences under the STA. A dispute arose between the relevant parties and the same was adjudicated upon before the Telecom Disputes Settlement and Appellate Tribunal (TDSAT), wherein the TDSAT ordered the DoT to return the said bank guarantee.

Keeping in view of the said order, the resolution professional pursued Airtel Entities to release the bank guarantees. However, Airtel Entities communicated their willingness to pay the bank guarantee immediately upon the return of the bank guarantee by the DoT, subject to the right to claim set off of the net undisputed amount owed by Aircel Entities to Airtel Entities. Hence, Airtel Entities retained INR 1120 million by setting off against the total claim of INR 4537.3 million and paid only the balance of INR 3418 million to Aircel Entities and thereby filed this application before the NCLT, Mumbai Bench (NCLT) with the purpose to get an affirmation order about the said action.

In view of the above, the prima facie question raised was whether set off is permitted under the insolvency proceedings under the Code.

The NCLT held that Airtel Entities are legally entitled under the Code to set off the applicable amount for the following inter alia reasons:

If the set off is not granted, the resolution applicant may or may not propose a correct resolution plan after seeing the huge liability without analysing the benefit of set-off of credit amounts. Hence, it is necessary that a resolution applicant must be aware of the correct outstanding balances appearing on the date of commencement of insolvency in the balance sheet of the corporate debtor;

In view of the exception carved out under section 18(1)(f) of the Code, an asset owned by third party in possession of the Corporate Debtor held under trust or contractual arrangement shall not be taken over by the resolution professional;

The Code does not specifically bar that for CIRP only gross amount / claims are to be taken into account and the netting (set off) is permissible only in case of liquidation; and

Clause 8 of Form B (Submission of Claims) clearly provides for ‘details of mutual credit, mutual debit between the corporate debtor and the creditor’.