ACUITY LAW

# INSOLVENCY
## LAW NEWSLETTER

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## ABOUT ACUITY LAW LLP

Acuity Law LLP was founded in November 2011. Acuity Law LLP comprises of a team of young and energetic lawyers/ professionals led by Souvik Ganguly, Gautam Narayan and Deni Shah who have deep and diverse experiences in their chosen areas of practice. We advise 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 LLP takes pride in rendering incisive legal advice taking into consideration commercial realities. Our areas of practice are divided into three departments. The Corporate practice is led by Souvik Ganguly, the Global Trade and Tax practice is led by Deni Shah and the Disputes practice is led by Gautam Narayan.

As part of the Corporate practice, Acuity Law LLP 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

As part of the Global Trade and Tax practice, Acuity Law LLP under the leadership of Deni Shah advises on:

- Cross-border tax planning and jurisdiction analysis
- Strategies for acquisitions, mergers, divestitures, diversification or consolidation of businesses
- Inbound and outbound investment structuring
- Endowment planning / wealth management strategies
- Global Trade & Customs laws, including foreign trade policy
- International supply chain optimization
- Goods & Services Tax and other Indirect taxes

As part of the Disputes practice, Acuity Law LLP under the leadership of Gautam Narayan advises and represents clients on domestic and cross - border:

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

Acuity Law LLP 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 LLP, please visit our website acuitylaw.co.in or write to us at al@acuitylaw.co.in.

**INTRODUCTION**

This newsletter covers key updates about developments in the Insolvency Law during the month of January 2021.

We have summarized the key judgments passed by the Supreme Court of India (**SC**), the 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.

**1) SC UPHOLDS VALIDITY OF INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ACT 2020**

**Matter:** Manish Kumar vs. Union of India & Another.

**Order dated:** 19 January 2021

**Summary:**
The Insolvency and Bankruptcy Code (Amendment) Act 2020 ("**Amendment Act**") which came into effect from 13 March 2020 introduced two major changes to the Insolvency and Bankruptcy Code ("**IBC**"). It introduced a threshold that mandated that a minimum of 100 allotees or 10% of the total allotees of a real estate project, which ever is lower, should jointly apply for corporate insolvency resolution process ("**CIRP"**). Additionally, such allotees must be from the same real estate project. A third condition provided a 30 day timeline for existing allotees who had filed CIRP application, but whose applications were not yet admitted, to find the requisite support of meet the 100 allotees or 10% allotees threshold. In the event this threshold is not satisfied within 30 days, their applications would be deemed as withdrawn.

The Amendment also introduced Section 32A which extinguished the liability of a corporate debtor if a resolution plan gets approved by the NCLT and a new management takes over the corporate debtor. In other words, the new owners of the corporate debtor cannot be held liable for the past mis-deeds of the previous management of the corporate debtor.

It is pertinent to note that the amendment was introduced through an Ordinance on 28 December 2019, and thereafter the Amendment Act was passed. The Amendment Act was challenged in 41 Writ petitions before the SC mostly by real estate allotees.

The three Judge bench of the SC was of the opinion that there was an intelligible distinction between real estate allotees and other financial creditors on account of the sheer vast number of allotees and the heterogeneity and individuality in decision making. A threshold was needed to halt the indiscriminate litigation which would otherwise result in a uncontrollable docket explosion as far as the authorities which work under the Code are concerned. Pointing out the flaw in the previous regime, the SC stated that an individual allotee would throw the spanner in the works and bring the entire real estate project itself to a possible doom. Further, if several allotees are bunched together from various projects, it would lead to confusion as their complaints would vary depending upon the extent to which the particular project is completed. This would make the resolution process cumbersome. The SC appreciated the rationale behind the threshold of 100 allotees or 10% allotees from the respective real estate project. SC also upheld the retrospective nature of the amendment, observing that the amendment was neither capricious nor manifestly arbitrary. However, the three judge bench noted that a period greater than the provided 30 day period would have been undoubtedly more reassuring to the allotees whose applications are pending in NCLTs.

SC also upheld the validity of Section 32A stating that it was important that IBC provides bidder of corporate debtors protection from any misdeeds of the past management. Such protection must also extend to the assets of the corporate debtor. This will be beneficial for bidders in assessing the corporate debtor and to offer a reasonable and fair value for the corporate debtor and also to ensure timely completion of the CIRP. The SC also noted that Section 32A does not give a free chit to past management of the corporate debtor and therefore has sufficient checks to prevent exploitation of Section 32A.

**2) A COMPLETE AND PROPOER APPLICATION FILED BY AN OPERATIONAL CREDITOR CANNOT BE DISMISSED AND PARTIES CANNOT DIRECTED TO SETTLE ON THE GROUND THAT THE DEBT AMOUNT IS ONLY 4.35 LAKHS.**

**Matter:** Aster Technologies Pvt. Ltd. vs. Solas Fire Safety Equipment Pvt. Ltd.

**Order dated:** 05 January 2021

**Summary**

Appeal was preferred by Aster Technologies Pvt. Ltd. (**Appellant**) before the NCLAT against the order of NCLT, Bengaluru Bench, whereby the NCLT dismissed the application filed by the Appellant for initiating corporate insolvency resolution process against Solas Fire Safety Equipment Pvt. Ltd. (**Respondent**) on the ground that the operational debt is a small amount of Rs. 4.35 lakhs. In addition, directions were given to the Respondent to settle the matter with the Appellant. It is pertinent to note that the Respondent had not entered appearance before the NCLT.

The NCLAT observed that the approach of the NCLT was not in accordance with law and found the direction of the NCLT to the Respondent, who had not even appeared before the NCLT, to settle the issue to be inappropriate. Accordingly, the NCLAT set aside the order of the NCLT and remanded back the matter to the NCLT to consider the application as per provisions of IBC and decide the same as per law, after hearing the parties

**3) IF CORPORATE DEBTOR REFUSES TO ACCEPT DELIVERY OF DEMAND NOTICE, IT WOULD BE DEEMED THAT NOTICE HAS BEEN SERVED.**

**Matter:** Sri D. Srinivasa Rao vs. Vaishnovi Infratech Ltd.

**Order dated:** 05 January 2021

**Summary**

Appeal was preferred by Sri D. Srinivasa Rao (**Appellant**) before the NCLAT against the order of NCLT Hyderabad Bench, whereby the NCLT dismissed the application filed by the Appellant for initiating corporate insolvency resolution process against Vaishnovi Infratech Ltd. (**Respondent**) on the ground that the demand notice as mandated under the Insolvency and Bankruptcy Code, 2016 was not served on the Respondent as the same was returned unserved.

The NCLAT observed that the said matter was not a case of non-issuance / non-delivery of mandatory statutory notice under of Insolvency and Bankruptcy Code, 2016 on the part of the Appellant, but rather a case of refusal on the part of the Respondent to accept service of demand notice.

The NCLAT held that in such a case the NCLT would not be justified in coming to conclusion that notice has not been served on the Respondent and accordingly set aside the order of the NCLT and remanded back the matter to the NCLT to consider the application as per provisions of Insolvency and Bankruptcy Code, 2016 and decide the same as per law, after hearing the parties.

## 4) PRE-PACKAGED INSOLVENCY RESOLUTION PROCESS PROPOSED FOR INDIA BY THE MINISTRY OF CORPORATE AFFAIRS

**Notice Dated: 08 January 2021**

**Summary:**
The Ministry of Corporate Affairs has sought comments from public on Pre-packaged Insolvency Resolution Process ("**pre pack**") under IBC. An October 2020 report of the sub-committee of the Insolvency Law Committee ("**report**"), had designed a pre-pack framework within the basic structure of the IBC. A Pre-Pack is an arrangement for the resolution of the debt of a distressed company through an agreement withs its creditors. The practice of pre-packs was first developed in the US, following the enactment of the Bankruptcy Reform Act of 1978, followed by the United Kingdom and Europe, and very recently adopted by Singapore. A pre-pack seeks to provide the advantages of an out-of-court resolution in terms of time, costs and flexibility, while ensuring that the resolution plan is binding on all stakeholders.

The proposed pre-pack can only be initiated by the corporate debtor on commission of a default. However, such an application for initiation of pe-pack would also require prior approval of a simple majority in value of unrelated financial creditors. Once a pre-pack application has been admitted against a corporate debtor, a parallel CIRP cannot be initiated. In contrast to the creditor-in-control and resolution professional-led process for a CIRP, the debtor would remain in possession and control of its business during the pre-pack. However, important business decisions of the corporate debtor such as related party transactions, creating any security interest over the assets of the corporate debtor, change in charter documents of the corporate debtor, etc, would require prior approval of a simple majority in value of unrelated financial creditors.

The resolution professional's role in a pre-pack is akin to that under CIRP and would be limited to conducting the resolution process. A resolution process under the proposed pre-pack is to be completed within 90 days of admission as against the maximum 330 days for CIRP. On the date of initiation of the pre-pack, the management of the corporate debtor has to provide an information memorandum to the resolution professional detailing list of all the debts of the corporate debtor, and also the true financial standing of the corporate debtor. The report has also proposed making the officers of the corporate debtor criminally liable for supplying inaccurate, incomplete or misleading information. Similar to a CIRP, the approval of a resolution plan would require approval of financial creditors holding 66% in value of the financial debt. However, the financial creditors, by vote of 75% in value can approve to end the pre-packs at any stage and opt for liquidating the corporate debtor. The Report also introduces the concept of a 'Swiss Challenge' to ensure that the best resolution plan which maximises the value of the corporate debtor is considered and approved by the financial creditors. The promoters of the corporate debtor would be given an opportunity to submit a base resolution plan. In case the plan impairs the rights of operational creditors (by requiring them to take a haircut on the amounts owed to them), the process must be laid open to a Swiss challenge where third-party bidders will be permitted to submit resolution plans. The promoter too would be given an opportunity to match the third party bid. However, if the resolution plan submitted by the promoters of the corporate debtor does not impair the rights of the operational creditors' and the dissenting financial creditors, the committee of creditors can proceed with voting on the resolution plan, without invoking the Swiss challenge.

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