

ARTICLE

Insolvency and Bankruptcy Code, 2016 Judicial Somersault and Key Challenges for Insolvency Professionals



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Background

Insolvency and Bankruptcy Code, 2016 (IBC) has rightly been dubbed as the game changer of Indian business scenario. It has been one of the key factors contributing to India's steep climb up in the ladder of 'Ease of Doing Business Index' by 30 notches to the 100th position¹. For the first time, in India, large borrowers of public money seems to be a worried lot and are desperately trying to put their houses in order to avoid insolvency proceedings. The administration, regulator and judiciary, all are working in tandem and at an unprecedented pace to achieve the desired results. Within a little more than a year, the Hon'able Supreme Court (SC) has decided about 17 cases settling the key issues; IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, have been

amended four times and an ordinance was brought in to amend IBC to plug the loop holes and the possible misuse of the law.

The legacy of politically sponsored and hyped loan *melas* and write offs; strong nexus of politicians, bureaucrats, bankers, professionals, industry and business; lax monitoring and lack of stringent corrective action by regulators lead to the accumulation of mindboggling *Everest* of the non-performing assets (NPAs). The creative nexus influenced policy making, tinkering with it and devising new and innovative means to siphon off public money. Lenders hived off bad loans to a new creature called 'Assets Reconstruction Companies' (ARCs) to clean up their balance sheets and start all over again with the lending spree. When NPAs reached alarmingly levels again, ARCs came to their rescue. A very senior judge observed in an open court that it is only in India that the banks give new loans for the payment of interest on their old loans.

Interest rates on small savings of lower and middle classes were curtailed to make cheaper loans available for the large business houses. It was supposedly

¹World Bank Report-Doing Business 2018: Reforming to Create Jobs, Published on October 31, 2017

done to accelerate economic development and thereby generating employment and higher income levels for people at large. But in the process most of the public money was lost to fraudsters or the poor management. A growing population of senior citizens, without adequate social security and being dependent on the interest income from their life savings, were hit the hardest.

Judicial Somersault

The Insolvency Law is evolving and settling down with pronouncements of NCLAT and SC and amendments in the Act and Regulations. But this process is adding to the challenges of the Insolvency Professionals (IP).

NCLAT setting aside the order for CIRP

NCLAT while setting aside the order for the CIRP, declares illegal all the actions taken by the Interim Resolution Professional (IRP), including the publication of notice, though graciously directing the Adjudicating Authority (AA) to fix the fee of IRP for the period he has functioned and directing the Corporate Debtor (CD) to pay the same².

Withdrawal of application after Admission by the Adjudicating Authority

Rule 8 of Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules 2016 permits withdrawal of the application made for the CIRP by the applicant before its admission by AA. But there is no provision for withdrawal after the application has been admitted and CIRP has commenced.

National Company Law Appellate Tribunal (NCLAT) upheld that once CIRP application is admitted, it cannot be withdrawn, the matter cannot be closed till claim of all the creditors are satisfied by the corporate debtor following the procedures laid down under IBC. The reason for such order was that Rule 11 of NCLT and NCLAT Rules, for exercising inherent power has not been adopted for the purpose of IBC³. In appeal against this order of NCLAT, the Hon'ble Supreme Court (SC), held that the NCLAT could not utilise the inherent power under Rule 11 but utilized its own powers under Article 142 of the Constitution of India and allowed settlement. Following this, SC has also approved settlement in a number of other cases resulting in termination of CIRP and removal of IRP/Resolution Professional (RP)⁴.

² NCLAT in *S3 Electrical & Electronics Pvt. Ltd Vs Brian Lau*

³ NCLAT in *Lokhandwala Kataria Construction Pvt. Ltd. Vs Nisus Finance and Investments Managers LLP*

⁴ SC in *Lokhandwala Kataria Construction Pvt. Ltd. Vs Nisus Finance and Investments Managers LLP and Mothers Pride Dairy India Pvt. Ltd. Vs Portrait Advertising and Marketing Pvt. Ltd.*

In both the above situations i.e. a set aside order by the NCLAT or a settlement before the SC, the uncertainty of the process coming to an abrupt end remains at large and also puts in jeopardy the payment of his fee and other expenses incurred. IRP/RP has to approach NCLT for fixing his fee and for directions to the CD for payment. In many CIRP cases IRPs/RPs are facing non-cooperation by CD in getting payment of their fee and expenses. One such case is also pending before the SC.

A. Right of homebuyers to initiate CIRP

NCLT as well as NCLAT in *Col. Vinod Awasthy v. AMR Infrastructure Limited* have held that the flat buyers are neither financial creditors nor operational creditors under the IBC, as there is no supply of any goods nor rendering of any service. But in *Nikhil Mehra vs. AMR Infrastructure Limited*, NCLAT held the flat buyer with assured annual return is a financial creditor.

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This position does not seem to be in line with the recommendations in the Report of Banking Law Reforms Committee "The Committee proposes that **any creditor, whether financial or operational, should be able to initiate the insolvency resolution process** under the proposed code"⁵. So exclusion of home buyers from the definition of operational creditors deprives them of their basic rights. After moratorium, they cannot even approach Consumer Courts and they are neither considered financial nor operational creditors. Due to this precarious situation, homebuyers filed a writ petition before the Hon'able SC in *Jaypee case*. Excerpts from the BLRC Report as given in **Box 1** indicate that there was no intention to exclude homebuyers from the definition of operational creditors.

Role of Committee of Creditors (CoC)

With the concept of Creditors in Control under IBC, after the initiation of Corporate Insolvency Resolution Process (CIRP), the CoC assumes decision

⁵ The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design November 2015

making powers for the management of the CD. IRP/ RP is an independent professional to take care of the interests of all the stakeholders. Thus both IRP/RP and CoC have to work in tandem and in the overall interest of resolution while balancing the interests of all stakeholders. But in practice there is a clash of interest among the members of CoC per se and other stakeholders. Independence of IP is impacted by such a situation. A few areas of concern are being highlighted in this regard.

Replacement of IRP/RP

Section 22 (2) of the IBC provides that the CoC, may, in the first meeting, by a majority vote of not less than seventy-five per cent of the voting share, either resolve to appoint the IRP as RP or to replace the IRP with another RP. Similarly section 27 provides that the CoC may at any time replace RP with another RP. The well meaning provisions are generally twisted for furthering vested interests. Same is happening with this provision. Invariably in most of the CIRP cases initiated by an operational creditor (OC) or CD or a financial creditor (FC) other than the financial institutions, the CoC comprising of financial institutions, replaces the IRP with an RP of their choice and comfort. This not only puts a question mark on the credibility of the process of registration of IPs by the Insolvency and Bankruptcy Board of India (IBBI) but also hints at a nexus and leads to delay in the time bound process of resolution.

There is a mandatory timeline of 180 days to complete the CIRP, off course with a onetime extension of up to 90 days. Getting node of the AA for this change may take 30 to 60 days, which is a very crucial time in the total 180 days' time period for CIRP. Such change also leads to a request for extension of time beyond 180 days.

Apart from replacing the IRP, in some cases the CoC has gone to the extent of disapproving the fee of IRP and valuers appointed by him and asking the applicant to bear all the expenses, till the RP of their choice takes over. This is a brazen exercise of powers vested under IBC. There have also been cases where CoC tried even to malign the IRP/RP to bring in a RP of their choice at a very high fee.

One can imagine how independent an RP can be in line with the spirit of law when his appointment and fee is to be approved by the CoC, which is only one of the stakeholders. An RP, in such a situation, will surely be humanly inclined to please and impress the CoC, and may even cross the *laxman rekha* of his independence.

Interim Finance

Most the CoC members avoid agreeing to provide interim finance and put the responsibility to manage it on the RP. Such an attitude is the biggest handicap for IRP/RPs in managing the affairs of the CD as a going concern. Have they been so risk averse earlier the NPAs would not have piled up so much. The CoC members with adequate security interest are more inclined towards liquidation so that they can recover the full dues by spiking the resolution process.

Negative bias towards CD/Applicant

Both borrowers and lenders have been responsible for the unsustainable high levels of NPAs. But in the CIRP process the CD is always seen with an eye of suspicion as if there has been no fault on the part of lenders. In one case, an ex director of CD authorised his representative to attend the CoC meeting due to the exigency of death of his brother. His authorised representative was not allowed to attend the meeting by CoC. Legally the RP could have prevailed upon the CoC in allowing the representative to attend the meeting, but the RP toed the dictate of the CoC probably looking for more lucrative assignments or even fearing replacement.

Regulations 21(2) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, permits authorised representative for every participant. Regulation 21 (2) reads as "The notice of the meeting shall provide that a participant may attend and vote in the meeting either in person or through an authorised representative". Regulation 2 (1) (1) defines 'Participant' as a person entitled to attend a meeting of the committee under section 24 or any other person authorised by the committee to attend the meeting. Under section 24 members of suspended Board are also participants.

Further Proviso to Regulation 23 (3) allows the differently abled persons to make a request to the resolution professional to allow a person to accompany them at the meeting. A suspended Board member could also be a disabled person.

Therefore, as per the law there is no restriction on the authorised representative of suspended Board members attending the CoC meeting.

Thus, there is an urgent need to have a check on the arbitrary decision making by the Committee of Creditors specially regarding replacement of IRP/RP, approval of CIRP cost, Interim Finance and interference with the independent functioning of

IRP/RP. The mindset of CoC members needs a change that is oriented more towards resolution.

Box 1 Excerpts from the BLRC Report

Enterprises have financial creditors by way of loan and debt contracts as well as operational creditors such as employees, rental obligations, utilities payments and trade credit. (Pg 22)

Liabilities fall into two broad sets: liabilities based on financial contracts, and liabilities based on operational contracts. Operational contracts typically involve an exchange of goods and services for cash. (Pg 54)

The second set of liabilities are operational liabilities, which are more difficult to centrally capture given that

the counterparties are a wide and heterogeneous set. (Pg 54)

Operational creditors are those whose liability from the entity comes from a transaction on operations. (Pg 77) (Para 5.2.1).

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