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Insolvency Round-Up

Vol. I, Issue II

PREFACE

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Founding Partner

With each passing day, provisions of the Insolvency and Bankruptcy Code 2016 (the 'Code') undergo scrutiny of the adjudicating authority, the appellate authority and even the apex court in light of the facts and circumstances of varied cases. We have many interesting articles in this Insolvency Round-Up this month. Hope you enjoy reading this one!

To begin with, we discuss & analyze the fate of proceedings qua admitted application initiated under the Code where the parties to the application pending before the adjudicating authority have wriggled out a settlement amongst themselves in light of relevant provision(s) of the Code, rules made thereunder and recent judgments.

Then a case analysis (litigated before NCLT and thereafter before NCLAT) wherein the definition of "Financial Creditor" came under scrutiny and the tribunals examined whether subject-transaction was a simple sale transaction and the mere payment of assured returns was not enough to bring it under section 5(8) of the code as there was no consideration for the time value of money.

A brief analysis of section 14 of the Code and section 22 of Sick Industries Companies Act, qua moratorium and effect thereof on other ongoing proceedings has been included in this issue. Then there is a write-up on various provisions of the Code concerning claims of the creditors under a resolution process including various stages and aspects that are involved such as verification of claims, inclusion / exclusion of certain creditor, etc.

Next is an article on eligibility, scope, benefit, challenges, status of data repositories (or Information Utilities) of financial information envisaged under the Code.

This issue also includes case analysis pertaining to Essar Steel India Limited's petition before Hon'ble Gujarat High Court challenging the directions issued by Reserve Bank of India in a press release came out in June 2017.

We further discuss the 'avoidance provisions' enshrined in the Code and its implications on the preferential transactions, undervalued transactions, and extortionate credit transactions. Lastly, we examine liability of the promoter with regards to the personal property given as security when the moratorium period has commenced under the Code.

We sincerely hope that you find the articles of this *Insolvency Round-Up* issue interesting and throw more light on the various aspects of the Code.

Please feel free to send your valuable inputs / comments at newsletter@singhassociates.in.

Thank you.

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EFFECT OF SETTLEMENT BETWEEN THE PARTIES ON THE APPLICATION FILED AND ADMITTED UNDER INSOLVENCY AND BANKRUPTCY CODE, 2016

While two parties litigate out their dispute before a court of law, there is always a possibility that a mutual settlement may be arrived at during the course of proceedings. There may also be a case that the parties were already negotiating for settlement of dispute; however either of the parties moves the court / tribunal as a matter of abundant caution. This could include reasons such as negotiations not appearing to be productive, running out on limitation period, strategy, business call etc.

Here, we analyze the fate of proceedings initiated under Insolvency & Bankruptcy Code 2016 ("I&B Code") where the parties to the application pending before the adjudicating authority have wriggled out a settlement amongst themselves. However, there is a catch 22 situation! What if the application has been admitted by the adjudicating authority!

Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (the 'Adjudicating Authority Rules') has an answer to that. Rule 8 (*Withdrawal of application*) of the Adjudicating Authority Rules provides as under:

> "*The Adjudicating Authority may permit withdrawal of the application made under rules 4, 6 or 7, as the case may be, on a request made by the applicant before its admission.*"

In the matter titled "*Mother Pride Dairy India Pvt. Ltd. Versus Portrait Advertising & Marketing Pvt. Ltd.*", the Hon'ble National Company Law Tribunal (NCLAT) while noting that the dispute amongst the parties to the proceedings had been settled after admission of the application of the operational creditor, observed as under:

> "*However, it is not in dispute that the settlement has been made after admission of the application under Section 9 of the I&B Code, 2016. In view of Rule 8 of Insolvency & Bankruptcy (Adjudicating Authority) Rules, 2016, it was open to the Operational Creditor to withdraw the application under Section 9 before its admission but once it was admitted, it cannot be withdrawn even by the Operational Creditor, as other creditors are entitled to raise claim pursuant to public announcement under Section 15 read with Section 18 of the I&B Code, 2016.*"

In the *Mother Pride* (supra) case, the Hon'ble NCLAT while rejecting the appeal also made a direction that the impugned order passed by the adjudicating authority i.e. National Company Law Tribunal (NCLT) or order passed by the NCLAT will not come in the way of the appellant to satisfy and settle the claim of other creditors. If the appellant satisfies the claim of other creditors, whoever has made claim, in that case Insolvency Resolution Professional (IRP) will bring the matter to the notice of NCLT for closure of the resolution process. Further, NCLT in such case will consider the case in accordance with law, even before completion of Resolution process and may close the matter.

Similarly in *West Bengal Essential Commodities Supply Corporation Ltd. Versus Bank of Maharashtra*, the Hon'ble NCLAT rejected the submission regarding ongoing settlement discussions between the appellant and the financial creditors; and accordingly dismissed the appeal on the ground that the learned Adjudicating Authority having noticed that the application preferred by the respondent financial creditor is complete and in absence of any defect, admitted the application under section 9 of the I&B Code.

There is another aspect in a few cases that has been entertained by the Hon'ble NCLAT for deciding whether

the stage of admission of the application has been crossed to such an extent that the same cannot be permitted to be withdrawn. In below two cases, the Hon'ble NCLAT had to scrutinize the case on the ground whether the notice was served upon the corporate debtor before admitting the application or not in order to grant liberty to withdraw the application.

The Hon'ble NCLAT in *Agroh Infrastructure Developers Pvt. Ltd. Vs. Narmada Construction (Indore) Pvt. Ltd.* held that since the adjudicating authority did not serve notice upon corporate debtor before admitting the application (which was against the principles of natural justice) and also that the parties had settled the dispute, therefore the operational creditor could withdraw the application even after admission of the application by the Adjudicating Authority.

In Company Appeal (AT) (Insolvency) No. 103 & 108 of 2017 titled *Inox Wind Ltd. Vs. Jeena & Co.*, the Hon'ble NCLAT decided upon two appeals against two orders, one for admission of the application of operational creditor under section 9 of the I&B Code and the second one for appointment of IRP. In this case the appellant/ corporate debtor submitted that the impugned order has been passed by the Adjudicating Authority in violation of principle of natural justice i.e. without giving any notice to the corporate debtor prior to admission of the application while placing reliance was placed on the decision of the NCLAT in "*Innoventive Industries Ltd Vs ICICI Bank and Another"*. The appellant also apprised the NCLAT that the appellant is a solvent company and is in a position to pay the dues; moreover, the dues of the respondent/Financial Creditor stood paid as on date along with those of other financial creditor. The Hon'ble NCLAT, while noting the submissions of the appellant (also confirmed by the respondent) held that the order passed by the adjudicating authority for admission of the application was passed in violation of rules of natural justice and against the decision of the NCLAT in *Innoventive* case and therefore set aside both the impugned orders under challenge. In the result, the appointment of IRP, order declaring moratorium, freezing of account and all other order passed by NCLT pursuant to impugned orders and action taken by the IRP including the advertisement published in the newspaper calling for applications were declared illegal. Further, the NCLT was directed to close the proceedings and the appellant was released from the rigour of law. Accordingly, the appellant company was allowed to function independently through its Board of Directors with immediate effect.

In another case, Hon'ble NCLT, Division Bench Chennai in the matter titled "*M/s. Phoneix Global DMCC vs. M/s. A&A Trading International Pvt. Ltd.*" while exercising its inherent powers under Rule 11 of the National Company Law Tribunal Rules, 2016 (the 'NCLT Rules') recalled its order for commencement of corporate insolvency resolution process and declaration of moratorium. In this case pursuant to admission of section 9 application, the corporate debtor duly paid the outstanding amount and settled its dispute with the operational creditor. The Hon'ble NCLT observed that since IRP was not appointed as the operational creditor had not proposed any IRP and a reference to this effect was lying pending with the Insolvency & Bankruptcy Board of India resulting in no public announcement being made in the matter. The Hon'ble Tribunal further observed and noted that since the corporate debtor has confirmed (by way of affidavit) that there are no other dues towards any other creditors and that the corporate debtor has paid dues to the operational creditor, therefore the dispute stood settled between parties to the application. Accordingly, the Hon'ble NCLT was pleased to dismiss the application as withdrawn on three counts (i) non appointment of IRP, (ii) non issuance of public announcement and (iii) settlement of dispute between parties to the application.

Going further, the Hon'ble NCLAT in the matter titled "*Lokhandwala Kataria Construction Private Limited Versus Nisus Finance and Investment Managers LLP*" dismissed the appeal preferred by the appellant / corporate debtor against admission of application under section 7 of the I&B Code; and held that "*… before admission of an application under Section 7, it is open to the Financial Creditor to withdraw the application but once it is admitted, it cannot be withdrawn and is required to follow the procedures laid down under Sections 13, 14, 15, 16 and 17 of I&B Code, 2016. Even the Financial Creditor cannot be allowed to withdraw the application once admitted, and matter cannot be closed till claim of all the creditors are satisfied by the corporate debtor*". The Hon'ble NCLAT also rejected the submission of the appellant for invocation of inherent powers under Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 (the 'NCLAT Rules') as the said Rule 11 of the NCLAT Rules has not been adopted for the purpose of I&B Code and only Rules 20 to 26 have been

adopted in absence of any specific inherent power and where there is no merit, the question of exercising inherent power did not arise.

Against the above order, the corporate debtor preferred an appeal before the Hon'ble Supreme Court for decision on the question as to whether in view of Rule 8 of the Adjudicating Authority Rules, the NCLAT could utilize the inherent power recognized by Rule 11 of the NCLAT Rules to allow a compromise before it by the parties after admission of the matter. The Hon'ble Apex Court while concurring prima facie with NCLAT's view that the inherent power could not be so utilized; applied its powers under Article 142 of the Constitution of India put a quietus to the matter. The Hon'ble Apex Court disposed of the appeal by holding that since the parties undertook to abide by the consent terms in toto and that the appellant also undertook to pay the sums due on or before the dates mentioned in the consent terms therefore, it was fit case for withdrawal of application before the adjudicating authority.

In conclusion, on case to case basis there may be a very little scope that the application, after admission, may be permitted to be withdrawn. However, in entirety the mandate of Rule 8 of the Adjudicating Authority Rules is to be applied in letter and spirit.

NIKHIL MEHTA & SONS (HUF) & OTHERS V AMR INFRASTRUCTURE LIMITED – A LOOK AT WHY THE NCLAT OVERRULED THE NCLT

The Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "IBC") is a fairly new legislation and therefore the provisions are still in the early stages of interpretation and haven't become settled law yet. An example of such a provision can be found under section 5(7) of the IBC which defines "Financial Creditor". The definition of "Financial Creditor" came under scrutiny in the NCLT Principal Bench judgment of *Nikhil Mehta & Sons (HUF) & Others v AMR Infrastructure Limited*[1] and further before the NCLAT on appeal.[2]

In the given case, the Applicants-Appellants had signed a Memorandum of Understanding with the Respondent, wherein the Appellants would purchase properties from the Respondent. In return for a substantial portion of the total money paid upfront, the Respondent promised to pay monthly "assured returns" from the time of signing of the MOU till the time the possession was delivered to the Appellants. After paying these assured returns for some time, the Respondent defaulted on its payments. Following this, the Appellants filed an application under section 7 of the IBC. The question to be decided was whether this arrangement was a simple sale transaction and the Appellants were mere buyers or, whether the Appellants were financial creditors under section 5(7) read with section 5(8) of the IBC and therefore, were allowed to make an application under section 7 of the IBC.

The Appellants had contended that, the transaction was a method of raising funds from the market at low rate and the "assured returns" were in the nature of interest. The Appellants relied on an order passed by SEBI, wherein it held that such transactions where the developer assured to pay assured returns to the buyer "are not pure real estate transactions, rather they satisfy all the ingredients of a Collective Investment Scheme as defined under section 11AA of the SEBI Act." Based on this, the Appellants contended that the transaction was in the nature of "fund mobilisation activity" and the "assured returns" was nothing more than the interest paid on such funds. To support this contention, the Appellants also relied on the fact that in the balance sheet of the Respondent these assured returns were getting shown as "Commitment Returns" under "Financial Cost" and were also deducting TDS on this amount under the head "Interest, other than Interest on Securities."

The NCLT in its Judgment examined the definitions of "Financial Creditor and "Financial Debt". It came to the conclusion that a Financial Debt would be a debt along with interest that was disbursed against time value of money – meaning, that the inflow and outflow must be distanced by time and there would be some compensation for the time value of money. The NCLT observed –

> "The Key feature as postulated by section 5(8) is its consideration for time value for money. In other words, the legislature has included such financial transactions in the definition of 'Financial debt' which are usually for a sum of money received today to be paid for over a period of time in a single series of payments in the future. It may also be a sum of money invested today to be repaid over a period of time in a single or a series of instalments to be paid in the future."

Based on this logic, the NCLT concluded that the present transaction was a simple sale transaction and the mere payment of "assured returns" was not enough to bring it under sections 5(8) of the IBC as there was no "consideration for the time value of money".

On appeal, the NCLAT upheld the NCLT's observation regarding section 5(8) and "time value of money" being an essential requirement of a financial debt. However,

1 *(ISB)-03(PB)/2017 (January 23, 2017)*

2 *Nikhil Mehta and Sons v AMR Infrastructure Company Appeal (AT) (Insolvency) No. 7 of 2017 (July 21, 2017)*

it took a different view with respect to the Appellants' status as financial creditors. The NCLAT observed that in the MOU signed between the Appellants and the Respondent, the Appellants were referred to as "Investors". Thus, the Appellants were "investors" who were investing in a "committed returns plan" whereas, the Respondent agreed to pay a monthly committed return to their Investors. Logically, it followed that committed returns would be in the nature of "debt" under section 3(11) of the IBC.

Moving on to the debate regarding whether the debt would be a financial debt or not, the NCLAT after a perusal of the financial returns of the Respondent noticed that the assured returns payable by them were shown under "commitment charges", at par with "Interest on Loans" under the heading of "Financial Costs". In addition, the Respondent had also under section 194A of the Income Tax Act, 1961 deducted TDS from these payments under the head of "Interest, other than securities". Further, the NCLAT also observed that this transaction was of a nature that was a sale which had the commercial effect of borrowing and the Appellants had disbursed the amount against the "time consideration of money". Based on these factors, the NCLAT concluded that the amounts invested by the Appellants was not a mere sale transaction, but would indeed come under the meaning of Financial Debts under section 5(8) of the IBC.

It is pertinent to note that in an even more recent judgment of *Anil Mahindro and Another v Earth Iconic Infrastructure (P) Ltd*[3] the NCLAT reiterated the position it had taken in the *Nikhil Mehta Case*. In this case, the facts were similar to the *Nikhil Mehta Case*. An MOU was signed by the Appellants and the Respondents wherein the Respondents promised to pay "committed returns" till the time possession of the sale properties were handed over to the Appellants. When the Respondents stopped paying the committed returns amount, the Appellants filed an application under section 7 of the IBC. The Principal Bench of the NCLT Delhi rejected the application as it considered this transaction a simple sale transaction.[4] On appeal however, the NCLAT revered this finding. Based on its own pronouncement in the *Nikhil Mehta Appeal Judgment,* the NCLAT held that in the present case also, the Appellants were playing the role of investors, the money given by them to the Respondents was in the nature of a loan, satisfying the condition of amount "disbursed against the consideration for time value of money" and, the committed returns were in the nature of "interest". Thus, there was a debt under section 5(8) of the IBC and the Appellants were Financial Creditors under section 5(8) of the IBC.

3 Company Appeal (AT) (Insolvency) No. 74 of 2017 (August 2, 2017)

4 In line with its reasoning in *Nikhil Mehta v AMR Infrastructure (ISB)-03(PB)/2017 (January 23, 2017)*

TAKING CLUE FROM SECTION 22 OF THE SICA TO UNDERSTAND THE SCOPE OF MORATORIUM PROVIDED UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the **'Code'**) is enacted to consolidate and amend laws pertaining to insolvency and resolution. The Code aims to revive the corporate debtor and if there is no chance of revival then liquidation is the way out.

Revival is not an easy procedure and there are various problems which come in the way of effective implementation of revival process. To curb these problems, the Code tries to simplify the whole process and aims to make the National Company Law Tribunal (herein after referred to as the "**NCLT**") one stop forum. And to make the tribunal more powerful, section 14 has been enacted.

MORATORIUM

Section 14 of the Code provides moratorium. 'Moratorium' has been defined as "the suspension of a specific activity."[1] Moratorium has been dealt under section 14 as follows:-

14 - *Moratorium - (1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:—*

(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;

(b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor…

From the bare reading of the aforementioned provision, it can be stated that once the application under this Code gets accepted, moratorium gets triggered and all the pending proceedings against the corporate debtor will be put on hold. Moreover, no new proceedings can be initiated against the corporate debtor. The process seems simple but the same has its own limitations like pending winding up proceedings before high court against the same corporate debtor. This very issue has been raised in the case of *Union Bank of India* v. *Era Infra Engineering*. And due to the same issue, the tribunal put a hold on the proceedings to decide the scope of section 14 of the Code. The said case is sub judice before the NCLT, Delhi. However, the same issue was dealt by NCLT Ahemdabad in the case of *ICICI Bank Ltd.* v. *ABG Shipyard Ltd.* where the tribunal has stayed the winding up petition pending before high court by the virtue of section 14. Therefore, it can be stated that the scope of section 14 still lies in grey area and the need of the hour is to bring more clarity.

In addition to this, it must be kept in mind that the Code is at its nascent stage and yet to witness the development. Thus, it would be logical to study other Statutes which have similar provisions and how courts interpret the same. On these lines, the Sick Industries Companies Act (herein after referred to as the "**SICA**") may be referred.

1 *Black Law Dictionary; x ed.; pg - 1163*

SICA:-

The SICA had been enacted in the public interest to deal with the problems of industrial sickness. It contains special provisions for timely detection of sick and potentially sick industrial companies, speedy determination and enforcement of various measures with respect to such companies[2]. For the purpose of issue in hand, it is important to refer section 22 of the SICA.

Section 22 of the SICA, *inter alia*, says that no winding up proceedings can continue without the consent of the Board against the sick company where the inquiry is pending or the scheme is under preparation or the appeal is pending. Section 14 of the Code and section 22 of the SICA may not be the same, but the gist of both the provisions revolves around moratorium only. And in more than one occasion, the Apex court has discussed the scope of section 22. Thus, it will be vital to study what has been stated on the scope of section 22.

In the case of *M/s. Rishabh Agro Industries Ltd.* Vs. *P.N.B. Capital Services Ltd.*[3] the Hon'ble Supreme Court has stated the following:-

> *"... it cannot be said that despite existence of any of the aforesaid exigencies the provision of Section 22 would not be attracted after the order of winding up of the company is passed. The words "no proceeding for winding up of the industrial company or for execution distress or the like against any of the properties of the industrial company or for the appointment of receiver in respect thereof shall lie or be proceeded with further, leave no doubt in our mind that the effect of the section would be applicable even after the winding up order is passed as no proceeding even thereafter can be proceeded ..."*

In the case of *Real Value Appliances Ltd.* v. *Canara Bank & Ors.*[4]; the Apex Court held the following:-

> *"once the reference is registered and when once it is mandatory simultaneously to call for information/documents from the informant and such a direction is given, then inquiry under Section 16(1) must - for the purposes of section 22 - be deemed to have commenced. Section 22 and the prohibitions contained in it shall immediately come into play."*

In the case of *S.M. Singhvi v. Bestavision Electronics*[5], the Delhi High Court has relied upon the aforementioned case laws and came to similar conclusion.

Based upon the aforementioned discussion on section 22 of the SICA, it is quite clear that court had given wide interpretation to the scope of section 22 and put a hold on other proceedings which fall under the ambit of the said section. And if we refer various case laws[6] dealing with the issue of scope of section 14 of the Code, it can safely be assumed that the bent of the adjudicating authority is to get abide by the mandate of section 14 of the Code and the same is very helpful because it reduces the multiplicity of the proceedings.

2 *Relied upon the following link - http://bifr.nic.in/objectives.htm (last accessed on 09/08/2017)*

3 *AIR 2000 SC 1583*

4 *AIR 1998 SC 2064*

5 *MANU/DE/0445/2003*

6 *Reliance can be placed upon the following case laws – Union Bank of India v. Era Infra Engineering; Industrial & Commerce Bank of China v. Alok Industries Ltd.; ICICI Bank Ltd. v. ABG Shipyard Ltd.*

CLAIMS OF CREDITORS IN THE RESOLUTION PROCESS

There is an overlap of duties when it comes to adjudication of the claims of creditors. Section 18 of the Insolvency & Bankruptcy Code enumerates the duties of the interim resolution professional. It states that the interim resolution professional shall receive and collate all the claims submitted by creditors to him pursuant to public announcement made by him.[1] After the committee of creditors is constituted by the Interim Resolution Professional[2], a meeting of the committee of creditors is convened by him. In the first meeting, the Resolution Professional is appointed by the Committee of Creditors.[3] Section 25 enumerates the duties of the Resolution Professional. It states that the Resolution Professional has to maintain the updated list of claims.[4] After the determination of the claims of creditors, the information memorandum is prepared based on which the Resolution Plan of the Corporate Debtor is prepared.

The Insolvency and Bankruptcy Board of India (Insolvency Resolution process for Corporate Persons) Regulations, 2016 (hereinafter referred to as "Regulation") throws light on the process of determination of the amount claimed by the creditors. The claims have to be made in accordance with the Forms specified in the Schedule of the Regulations.[5] These claims are proved on the basis of the records available with the Information Utility and other relevant documents like financial statements as evidence of debt, an order of a court that adjudicated on the non-payment of debt, contract for the supply of goods and services to the Corporate Debtor, or invoice demanding payment for goods and services provided to the Corporate Debtor etc.[6] The Interim Resolution Professional or the Resolution Professional may call for other evidence or clarification for the substantiation of the whole or part of the claim.[7] The Interim Resolution Professional or the Resolution Professional verifies the claim within a period of seven days from the last date of the receipt of claims and thereupon maintain a list of creditors containing names of creditors along with the amount claimed by them and the amount of their claims admitted.[8] This list of creditors is displayed on the website of the corporate debtor. It is also filed with the Adjudicating Authority and needs to be presented in the first meeting of committee of creditors.[9] However, where the amount claimed by a creditor is not precise, interim resolution professional or the resolution professional shall make the best estimate of the amount based on the information available to him. As and when the additional information with respect to the determination of claims is brought to the notice of the interim resolution professional or the resolution professional, he can revise the amount of claim depending on the information.[10]

The Code provides for proof of claims being submitted and verified twice. Depending on a case-to case basis, it is either the Interim Resolution Professional or the Resolution Professional who determine the claim of creditors. When the Interim Resolution Professional and the Resolution Professional appointed thereafter is the same person then there is no overlap of duties. However, if the Interim Resolution Professional is replaced by the Committee of Creditors, it is not clear whether he will re-determine the amount of claim of the creditors ascertained by the Interim Resolution Professional. Further, once the amount has been ascertained by the Resolution Professional, there is no

1 *Section 18(b), the Bankruptcy and Insolvency Code, 2016;*
2 *Section 21(1), the Bankruptcy and Insolvency Code, 2016;*
3 *Section 22(1), the Bankruptcy and Insolvency Code, 2016;*
4 *Section 25(e), the Bankruptcy and Insolvency Code, 2016;*
5 *Regulation 7, 8, and 9, The Insolvency and Bankruptcy Board of India (Insolvency Resolution process for Corporate Persons) Regulations, 2016;*
6 *Ibid;*
7 *Regulation 10, The Insolvency and Bankruptcy Board of India (Insolvency Resolution process for Corporate Persons) Regulations, 2016.*
8 *Regulation 13(1), The Insolvency and Bankruptcy Board of India (Insolvency Resolution process for Corporate Persons) Regulations, 2016;*
9 *Regulation 13(2), The Insolvency and Bankruptcy Board of India (Insolvency Resolution process for Corporate Persons) Regulations, 2016;*
10 *Regulation 14, The Insolvency and Bankruptcy Board of India (Insolvency Resolution process for Corporate Persons) Regulations, 2016.*

forum for the creditor to raise a dispute regarding such determined amount. For instance, if the creditor is not in agreement with the "best estimate" so determined, he has no recourse. There is lack of clarity and remains unaddressed by the Code.

However, by way of Interim Application the unsatisfied creditors have started moving an application before Adjudicating Authority. Recently, in *SBI v. S. Muthuraja & Ors (CA (AT) (Insolvency) No. 105 of 2017)* pending before Hon'ble NCLAT where SBI has filed an application for not being made a party to committee of the creditors by Interim Resolution Professional.

No doubt, many such applications will be filed before the adjudicating authority by the Corporate Debtor or the creditors or those who have any grievance from the Resolution Professional appointed.

UTILITY OF INFORMATION UTILITIES

The Insolvency and Bankruptcy Code (the Code) is seen as a welcoming step to address the problem of stressed assets for investors and lenders. A key mechanism which the Code envisages is the formation of Information Utilities (IU). IU would be the entities that would act as data repositories of financial information which would receive, authenticate, maintain and deliver financial information pertaining to a debtor with a view to facilitate the insolvency resolution process in a time bound manner.

ELIGIBILITY AND CONSTITUTION

According to the Rule 3 of Insolvency and Bankruptcy Board of India (Information Utilities) Regulations 2017, a public company having a net worth of more that Rs 50 crore can apply to set up an IU. Ordinarily, no single person can hold more than 10% of the paid-up equity share capital of an IU[1]. However, there are exceptions defined in case of Government Companies, Banks, Insurance Companies, Stock Exchanges and Public Financial Institutions. Also, among other requirements, more than half of its Directors on the Board should be Independent Directors[2].

SCOPE OF SERVICES

The IUs are expected to provide a host of services to fast track and make efficient the entire resolution process by ensuring that the data is validated and available at request to facilitate quick resolution. Key services which the IU is expected to deliver are:

- Accepting, recording and maintaining electronic record of financial information pertaining to companies availing lending facilities;
- Validating the data submitted;
- Providing access/ data to the information available.

BENEFITS

The IU is expected to record and validate all financial information pertaining to a debtor. The financial information so recorded will include the details of loans availed, defaults, charges, etc. Availability of such information, which is pre validated, will prove to be beneficial not just in case of insolvency resolution but also while advancing credit by any lender. Key benefits that can be expected are:

- Better decision making by lenders while advancing loans
- Opportunity for debtors to raise disputes, if any, regarding the information available
- Faster resolution with all pre-validated information available at one place

CHALLENGES

While there are immense benefits which result from the smooth functioning of the IU, the road is not without challenges:

- Data integrity: An IU will receive data from multiple sources and expected to maintain a single and validated version of the same.
- Data Security: Any data breach or misuse will seriously dent the user confidence and would bring the other useful entity to a naught.
- Access/ availability: The relevant data, unless available, when requested would be of no use.

CURRENT STATUS

In June 2017, National e-Governance Services Ltd. (NeSL) became the first entity to have received the in-principle approval for establishing an IU. Over 80 percent of its shareholding is currently held by major Government Financial Institutions like State Bank of India, Life Insurance Corporation, Canara Bank and Bank of Baroda.

1 *Rule 8 of the Insolvency and Bankruptcy Board (Information Utilities) Regulations 2017.*

2 Rule 9 of the Insolvency and Bankruptcy Board (Information Utilities) Regulations 2017.

CONCLUSION

Creation of an IU is important step towards effective management of the insolvency resolution process. There is no doubt about the significance of the IUs; however, it may take a while before they become relevant. Over a period of time the data available with the IUs will grow in size and if they are able to ensure necessary safeguards then they are bound to be an important pillar in the overall resolution process.

ANALYSIS OF GUJARAT HIGH COURT DECISION ON ESSAR STEEL INDIA LIMITED APPLICATION

BRIEF FACTS

Essar Steel India Limited ("Essar/Company") had filed a petition before Hon'ble Gujarat High Court ("Hon'ble High Court") challenging the directions issued by Reserve Bank of India ("RBI") in a press release came out in June 2017. In the said petition filed before the Hon'ble High Court, Essar had challenged the criteria chosen by RBI in selecting 12 companies and referring them to NCLT for insolvency proceeding under newly enacted Insolvency and Bankruptcy Code, 2016 ("I&B Code").

CONTENTION BY ESSAR

1) The primary contention of Essar was with respect to the power of RBI to direct NCLT to try certain cases on priority basis. Essar had contended that the press release issued in June 2017 was arbitrary and unjust. Further, the directions from RBI has no rationale and justification, whatsoever, to determine the companies to be tried before NCLT. Furthermore, it was also apprehended by Essar that the Application filed against it before the Adjudicatory Authority (NCLT, Ahmedabad) was due to such directions of RBI and not the own decision of the Financial Creditor;

2) Another concern raised by Essar was with respect to Insolvency Resolution Professional ("IRP") appointment after the admission of the application, as mandated under I & B Code. Essar argued that as the Company has large magnitude of operation and such huge business can be at risk particularly when managed by a new person having no expertise of the field. Moreover, Essar argued that it has achieved considerable amount of progress including repayment of 3,500 crores to the Banks which clearly shows that resolution process is eminently possible without any intervention or reference to the Adjudicating Authority (NCLT) as directed by RBI;

3) The third contention of Essar was that RBI has ignored the fact that the Company has reached the final stage of negotiation of Debt Restructuring Scheme with its lender and the restructuring plan would be ready soon. The direction of RBI to take action of filing insolvency petition even in respect of companies where restructuring proposal is under consideration is clearly discriminatory and required to be struck down;

4) The other contention which was placed by Essar was that the Section 35AA of the Banking Regulation Act, 1949[1] ("BRA") authorize the RBI to give direction to banking companies to initiate Insolvency Resolution Process in respect of a default. Essar contended that RBI has to come to subjective satisfaction on the basis of objective facts to give such directions. In the given facts, RBI has given a generic direction which is bad in law.

CONTENTION BY RBI

1) RBI had contended relying on the current situation of increase in the Non-Performing Assets ("NPA"). RBI argued that as on March 31, 2017 the gross NPAs in India had aggregated more than 5% of the Total GDP of the country. About 12% of the total advances by public sector banks are NPAs. Such increase in NPAs is grossly against the economy of the country. Therefore, such direction has been released to banks;

2) RBI informed the Hon'ble Court that the NPA of Essar rose from Rs. 31,671 crores till 31 March, 2016 to Rs. 32,864 crores till 31 March, 2017. Therefore, the directives are not on any "imaginary grounds" or arbitrary as alleged by Essar;

1 Section 35AA of BRA enables Union Government to authorize RBI to direct the banking companies to resolve specific stressed assets by initiating insolvency resolution process, where required. The RBI has also been empowered to issue other directions for resolution and appointment or approve for appointment, authorities or committees to advise banking companies for stressed asset resolution.

3) RBI has further argued that section 35AA of BRA empower bank to initiate insolvency proceedings before the NCLT and there is no restriction on initiation of proceedings even if negotiations between the borrowers and the financial creditors are going on.

HON'BLE HIGH COURT REASONING:

1) While analysing the provisions of I&B Code, the Hon'ble High Court observed that the bank has right to initiate the Insolvency Proceeding but filing of the application would not amount to admitting. The Adjudicatory Authority needs to decide w.r.t admission of the said application filed on the basis of the factual details in hand. Moreover, the Adjudicatory Authority certainly requires extending reasonable opportunity and hearing to the company to explain as to why such application should not be admitted;

2) The Hon'ble Gujarat High Court further observed that the amended provisions of BRA certainly gives power to RBI to issue certain directions to banks so as to see that there is proper recovery of public money, therefore, the issuance of press release cannot be quashed. However, the Hon'ble High Court gave an observation that while making any directions RBI must consider the necessity of doing so. There must be some substance and there must be a speaking order. The process cannot be initiated mechanically;

3) The Hon'ble Gujarat High Court also observed the careless and haphazard construction of the RBI's press release, by noting that the usage of the phrase, *"such cases will be accorded priority basis by the NCLT..."* was a serious concern as *"nobody is entitled or empowered to advice, guide or direct a judicial or quasi judicial authority in any manner whatsoever"*.

4) The Hon'ble Gujarat High Court also mentioned that the issue of appointment of IRP and taking over of business and management of such large enterprise by non-expertise person might cause hindrance in the smooth functioning of the Company. But such issue can be raised before NCLT. Under article 226 of the Constitution, this Hon'ble High Court does not wish to entertain such issues.

The Hon'ble High Court based on above observations disposed the petition filed by Essar. It would though be worth mentioning that I&B Code 2016, itself bars the jurisdiction of Civil Courts and the present judgment of Hon'ble High Court of not entertaining the plea of Essar even though having supervisory jurisdiction further strengthens the sanctity of the I&B Code 2016.

AVOIDANCE OF SPECIFIED TRANSACTIONS UNDER INSOLVENCY AND BANKRUPTCY CODE, 2016

Whenever a person is declared as insolvent, certain transactions undertaken during the process of insolvency or even before that are avoided to overturn their effects on the finances of the corporate debtor. The provisions are generally called as 'avoidance provisions' and are present in insolvency laws of almost all jurisdictions. They ensure that the value of assets of the company is maximized and all the creditors get their dues in an equitable manner. These provisions aim at setting aside transactions which are preferential in nature. Section 536 and 537 of Companies Act, 1956 provides for avoidance of transfers, certain attachments, executions, etc. after commencement of winding up. Similarly, Sections 328-331 of Companies Act, 2013 provide for avoidance of certain transaction undertaken before or after the commencement of winding up proceedings.

The recent I&B Code, 2016 (*hereinafter*, 'the Code') also includes detailed provisions with respect to avoidance of certain transactions. Clause (j) of Section 25(2) casts a duty on the Resolution Professional to file application for avoidance of transactions, if there is any. The application is to be filed in accordance with Chapter III of Part II of the Code. The application for avoidance may be filed during both Corporate Insolvency Resolution Process and Liquidation Process. Sections 43-51 of the Code deal with avoidance of certain transactions. The transactions are divided into three categories: preferential transactions, undervalued transactions and extortionate credit transaction. For avoiding or setting aside the transactions there is a "relevant period" which is prescribed under various provisions of the code. Transactions undertaken during this "relevant period" only can be avoided.

PREFERENTIAL TRANSACTION

Certain transactions may be avoided under sections 43 of the Code if it appears that they have been preferred over others. The liquidator or the resolution professional has to make an application to the Adjudicating Authority for avoidance of such transactions where he is of the opinion that they have been preferred. In addition to this, sub-section 2 of section 43 of the Code lists down certain transactions which shall be deemed to have been given a preference. It covers transaction where there is a transfer of property or an interest in respect of an existing debt or liability, and such transfer has the effect of putting such creditor in a beneficial position than it would have been in the event of a distribution of assets u/s 53 of the Code. But any transfer which is made in the ordinary course of business or which creates a security interest in the property acquired by the corporate debtor shall not be a preferential transaction.[1]

The relevant time for preferential transaction is two years preceding the insolvency commencement date, if it made to a related party and one year if it is made to a person other than a related party.[2] Related party is someone who is related to the entity, in this case corporate debtor, in one way or the other. Section 5(24) of the Code provides a list of people who are taken as related party for the purposes of this code.

On receiving an application for avoidance of preferential transaction, the Adjudicating Authority may pass following orders:[3]

(a) vesting, in the corporate debtor, of transferred property or the property which represents the application of proceeds of transferred property;

(b) release or discharge of any security interest created by the corporate debtor;

(c) require a person to pay such amount in respect of benefit received by him;

(d) direct any guarantor to be under new or revived debts, whose earlier debts were released preferentially;

1 *Section 43 of I&B Code, 2016.*
2 *Section 43(4) of I&B Code, 2016.*
3 *Section 44 of I&B Code, 2016.*

(e) direct for subjecting any property under charge for discharge of any financial or operational debt;

(f) direct for providing the extent to which a person, whose property is so transferred or on whom debts have been imposed, can prove his debt in the insolvency process or the liquidation process.

UNDERVALUED TRANSACTION

According to Section 45(2) of the Code an undervalued transaction is one where corporate debtor makes a gift or transfers one or more assets for insignificant consideration, provided that such transaction has not taken place in the ordinary course of business of the corporate debtor. Also, the resolution professional or the liquidator can make an application to the Adjudicating Authority with respect to preferential transactions u/s 43(2) of the Code, if they find them to be undervalued and made during the relevant period. The relevant period for avoiding a transaction at undervalue is given under section 46 of the Code. For transaction made with a related party the relevant period is two years preceding the insolvency commencement date, and for transactions made with any other person this period is one year preceding the insolvency commencement date.

Furthermore, in case of undervalued transactions, right is also given to a creditor, member or partner of a corporate debtor to make an application to Adjudicating Authority, if the liquidator or the resolution professional has not reported the same. After examination of the application if the Adjudicating Authority is satisfied that the liquidator or the resolution professional, despite having sufficient information did not report such transaction, they can pass an order requiring the Board to initiate disciplinary proceedings against them.

The effect of the application is that the transactions are declared void and the effects are reversed. The Adjudicating Authority may pass the orders under section 48 of the Code of following nature:

(a) require any property transferred as part of the transaction, to be vested in the corporate debtor;

(b) release or discharge (in whole or in part) any security interest granted by the corporate debtor;

(c) require any person to pay such sums, in respect of benefits received by such person, to the liquidator or the resolution professional as the case may be, or

(d) require the payment of such consideration for the transaction as may be determined by an independent expert.

EXTORTIONATE CREDIT TRANSACTIONS

Extortionate credit transactions are the credit transactions which involve the receipt of financial or operational debt to the corporate debtor. They are termed as extortionate because the terms are either unconscionable, or require the corporate debtor to make exorbitant payments in respect of the credit provided.[4] However, a debt which is in compliance with any law for the time being in force in relation to such debt shall in no event be considered as an extortionate credit transaction.[5]

Whenever, an application for avoidance of credit transactions are made to the Adjudicating Authority, it has to satisfy itself that the terms require exorbitant payments to be made by the corporate debtor. Where it is so satisfied, the Adjudicating Authority can make the following orders with respect to the transactions:

(a) restore the position as it existed prior to such transaction;

(b) set aside the whole or part of the debt created on account of the extortionate credit transaction;

(c) modify the terms of the transaction;

(d) require any person who is, or was, a party to the transaction to repay any amount received by such person; or

(e) require any security interest that was created as part of the extortionate credit transaction to be relinquished in favour of the liquidator or the resolution professional, as the case may be.

4 *Regulation 5 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.*

5 *Explanation to section 50(1) of the Code, 2016.*

Thus, the provisions for avoidance of transactions make sure that the transactions, which have no commercial purpose otherwise, and have been undertaken only to benefit some creditors or to hamper the process of insolvency or liquidation, are set aside. The provisions help to correct the situation when a certain transfer of property is made merely to keep the property away from the pool of assets to be divided among the creditors. However, the principles of avoidance are to be exercised cautiously so that valid transactions undertaken in the normal course of business are not reversed.

LIABILITY OF THE PROMOTER WITH REGARDS TO THE PERSONAL PROPERTY GIVEN AS SECURITY WHEN THE MORATORIUM HAS BEEN ISSUED

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the "**Code**") provides for a time-bound resolution process for insolvency and bankruptcy. Part II of the Code, provides for the procedure for the insolvency resolution wherein financial creditors, operational creditors or corporate debtors themselves can approach the Adjudicating Authority for initiation of corporate insolvency resolution process under the provisions of Sections 7, 8, and 10 respectively. Section 10 of the Code deals with the application for the initiation of the corporate insolvency resolution process by the Corporate Debtor itself, where sub-section (1) provides that when a corporate debtor has committed a default[1], the corporate applicant[2] can file an application for initiating the corporate insolvency resolution process with the Adjudicating Authority.

Once the application under sub section 4 is admitted, the Corporate Insolvency Resolution Process (hereinafter referred to as CIRP) commences. In this situation, Section 14 of the Code comes into the picture because it states that a moratorium shall be issued from the insolvency commencement date. A moratorium under the Code, prohibits the institution of suits or continuation of pending suits against the corporate debtor, the transferring encumbering alienating or disposing of the corporate debtor any of its assets or legal rights therein, further it also prohibits any action to foreclose, recover, or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFAESI Act, 2002. It is this limb of the moratorium that this article will be focusing on.

Moratorium is a very effective tool, however, sometimes it has been used to thwart or frustrate the Recovery Proceedings by the Corporate Debtor. Due to this reason, the question that whether the personal properties of the promoters which have been given as security can escape liability during the moratorium period comes to the fore.

1 *Section 2 (12)*
2 *Section 5 (5)*

PERSONAL LIABILITY OF THE PROMOTER WHEN THE MORATORIUM HAS BEEN ISSUED

Recently in the case of Schweitzer Systemtek vs. Phoenix ARC Limited[3], the Mumbai bench of the NCLT was asked to adjudicate on the issue that whether the personal properties of the promoters which have been given as security to the bank/creditor come under the purview of the moratorium as envisaged under Section 14 of the Code or not. In this case, Dhanlaxmi Bank had lent Rs 4.5 crore to the company wherein the promoter had pledged personal properties. The bank sold the loan along with security to Phoenix ARC. M/s Schweitzer Systemtek had filed for the initiation of CIRP under Section 10 (3) which was opposed by Phoenix ARC fearing that if the case is admitted, a moratorium under Section 14 of the Code will be issued, which could thwart the action taken so far for recovery of the outstanding loans which included selling personal properties of the promoters which were in an advanced stage.

The Tribunal perused the facts and came to the conclusion that the admitted position of the debtor is that the personal properties have been given as a "Security" to the banks which clearly implies that the properties are currently not under the ownership of the Corporate Debtor. In that regard, to ascertain that whether the properties which are not owned by a Corporate Debtor will come within the ambits of the Moratorium or not, the Tribunal examined Section 14 (c) of the Code and observed that the canon of interpretation is a very important tool for gauging the

3 *T.C.P No. 1059*

intention of the legislature and language of the Statute is such that no word can be added, or substituted or deleted from the enacted Code, thereby the term "its" in the aforementioned section becomes very important because on a plain reading of the section it is understood that on the commencement of the Insolvency Process, the Moratorium shall be declared for prohibiting any action to recover or enforce any security interest created by the Corporate Debtor in respect of its property, the usage of the word "its" clearly makes a distinction between the property owned by the Corporate Debtor and other properties, which means that the Moratorium will have no application on the properties beyond the ownership of the Corporate Debtor. In this case, since the property in question was given as security to the bank, the moratorium would not apply on the personal properties.

This issue was also discussed in the case of "*Alpha & Omega Diagnostics (India) Ltd v/s Asset Reconstruction of India & Ors*[4]" before the Mumbai bench of the NCLT, where the tribunal took a similar stand and held that the personal properties of the promoters which have been given as security will not be affected by the Moratorium issued under Section 14 since the wordings of the section are very clear in their meaning that that the Moratorium applies only to the properties of the corporate debtor and therefore the personal properties of the promoters which have already been given as a security to the lending bank will remain unaffected by the Moratorium in effect, this reasoning was then challenged before the NCLAT[5], wherein it dismissed the appeal by affirming the order of the NCLT Mumbai bench.

4 *T.C.P. No. 1117,/I&BP/NCLT/MB/MAH/2017, Order dated 10.07.2017*

5 *Company Appeal(AT) (Insol) No. 116 of 2017, Order dated 31.07.2017*

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