Between the lines...

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Key Highlights

I. Supreme Court: Application for corporate insolvency resolution process can be withdrawn even after issuance of invitation for expression of interest

The Supreme Court in the case of ***Brilliant Alloys Private Limited v. Mr. S. Rajagopal and Others*** *(decided on December 14, 2018)* held that the application for corporate insolvency resolution process can be withdrawn even after issuance of invitation for expression of interest.

Facts

The National Company Law Tribunal, Chennai (**"NCLT"**) on September 28, 2017 allowed the petition filed by Brilliant Alloys Private Limited (**"Corporate Debtor"**) under Section 10 *(Initiation of corporate insolvency resolution process by corporate applicant)* of the Insolvency and Bankruptcy Code, 2016 (**"Code"**) and ordered commencement of the corporate insolvency resolution process (**"CIRP"**) and imposed moratorium as per the provisions of Section 14 (*Moratorium*) of the Code.

Since the settlement happened after the issue of invitation for expression of interest, an application under Section 12A of the Code (*Withdrawal of application under Section 7, 8 and 10*) would not have been allowed. Therefore, the resolution professional filed an application under Section 60(5)(a) of the Code (*Adjudicating authority for corporate persons*) which states that the NCLT shall have the jurisdiction to entertain or dispose of any application or proceeding by or against the corporate debtor or corporate person. The aforesaid application was to allow for the withdrawal of the CIRP and remove the corporate debtor from the clutches of the Code. The Division Bench of the NCLT passed an order dated November 11, 2018 dismissing the application stating that since Regulation 30A of the Insolvency and Bankruptcy Board of India (*Insolvency Resolution Process for Corporate Persons*) Regulations, 2016 (**"CIRP Regulations"**) imposes conditions for withdrawal of application that it has to be filed

before invitation for expression of interest, NCLT cannot pass an order allowing the withdrawal ignoring the conditional clause. Aggrieved by the order of the NCLT, the Corporate Debtor approached the Supreme Court under Article 136 (*Special leave to appeal by the Supreme Court*) of the Constitution of India and the following issue came up for determination:

Issue

Whether the application for CIRP can be withdrawn even after the issuance of invitation for expression of interest under the Code.

Observations of the Supreme Court

The Supreme Court observed that despite the Corporate Debtor, financial creditor and operational creditor agreeing to the same, the only reason the application to withdraw the CIRP failed was because Regulation 30A of the CIRP Regulations states that withdrawal cannot be permitted after issuance of invitation for expression of interest. Regulation 30A of the CIRP Regulations has been reproduced hereinbelow:

"30A. Withdrawal of application.

(1) An application for withdrawal under section 12A shall be submitted to the interim resolution professional or the resolution professional, as the case may be, in Form FA of the Schedule before issue of invitation for expression of interest under regulation 36A.

(2) The application in sub-regulation (1) shall be accompanied by a bank guarantee towards estimated cost incurred for purposes of clauses (c) and (d) of regulation 31 till the date of application.

(3) The committee shall consider the application made under sub-regulation (1) within seven days of its constitution or seven days of receipt of the application, whichever is later.

(4) Where the application is approved by the committee with ninety percent voting share, the resolution professional shall submit the application under sub-regulation (1) to the Adjudicating Authority on behalf of the applicant, within three days of such approval.

(5) The Adjudicating Authority may, by order, approve the application submitted under sub-regulation (4)."

The Supreme Court, however went on to state that Regulation 30A of the CIRP Regulations must be read with the main provisions of Section 12A of the Code, which contains no such stipulations. Section 12A of the Code is reproduced below.

"12A. Withdrawal of application admitted under section 7, 9 or 10

The Adjudicating Authority may allow the withdrawal of application admitted under section 7 or section 9 or section 10, on an application made by the applicant with the approval of ninety per cent voting share of the committee of creditors, in such manner as may be specified."

The Supreme Court observed that the stipulation under Regulation 30A of the CIRP Regulations can only be considered to be directory and would depend on the facts of each case.

Decision of the Supreme Court

The Supreme Court set aside the NCLT's order and allowed the settlement. Subsequently, the CIRP was annulled.

VA View

This judgement keeps in mind the central theme of the Code, which is insolvency resolution of corporate persons and maximization of value of assets of all the stakeholders. In this instance, since the Corporate Debtor, operational creditors and financial creditors agreed to the withdrawal of the application for CIRP, the Supreme Court decided that it would be more beneficial to forgo the procedural aspects that had bound the NCLT from allowing the application for the withdrawal of the CIRP.

However, questions might be raised about the applicability of other procedural requirements of Regulation 30A of the CIRP Regulations on other cases of withdrawal, since the Supreme Court has clearly stated that the stipulations contained therein would depend upon facts of each case.

II. NCLAT: Liability of the corporate debtor towards the promoter-personal guarantor can be waived by the resolution plan

The National Company Law Appellate Tribunal (**"NCLAT"**) in ***Lalit Mishra and Others v. Sharon Bio Medicine Limited and Others*** *(decided on December 19, 2018)* held that a resolution plan that discharged the liability of the corporate debtor to pay off its personal guarantors who were also the promoters was not discriminatory in nature.

Facts

By way of order dated February 28, 2018, the National Company Law Tribunal, Mumbai (**"NCLT, Mumbai"**) approved the resolution plan approved by the committee of creditors of Sharon Bio Medicine Limited (**"Corporate Debtor"**). The dispute arose when the promoters of the Corporate Debtor (**"Appellants"**) felt short changed as the resolution plan did not provide for their dues, as personal guarantors, to be paid off.

The resolution plan stated that the personal guarantee provided by the existing promoters of the Corporate Debtor shall result in no liability towards the Corporate Debtor or the successful resolution applicants and all the securities of the Corporate Debtor would be released. Further, the resolution plan also envisaged a selective reduction of the share capital of the Corporate Debtor more particularly (i) the entire shareholding of the promoter group and secured lenders; and (ii) up to 90% of the equity shares held by the public shareholders. This resulted in the Appellants challenging the order of the NCLT, Mumbai approving the resolution plan on two counts:

1. The resolution plan did not envisage paying off the Appellants who were the promoters of the Corporate Debtor.
2. The resolution plan was discriminatory towards the Appellants who were also the personal guarantors of the Corporate Debtor.

Issue

Whether NCLT, Mumbai should have approved the resolution plan in light of the personal guarantors excluded from being paid off?

Arguments

The Appellants submitted that the payment terms provided in the resolution plan were in contravention to the applicable provisions of law. They also submitted that the successful resolution applicant had arbitrarily reduced or written off substantial liabilities of the Appellants without any legal basis. It was further pleaded that the lenders had not been treated similarly and restructuring for its entire claims of the Corporate Debtor was against the provisions of the Insolvency and Bankruptcy Code, 2016 (**"Code"**). The Appellants argued that the security interest which includes the personal guarantees of the Appellants had been reduced to 'nil' under the resolution plan. Therefore, the resolution plan was contrary to Section 133 and 140 of the Indian Contract Act, 1872 (**"Contract Act"**). Section 133 of the Contract Act provides that if any change is made in the terms of the contract between the principal debtor and the creditor without the surety's consent, it will discharge the surety from transactions subsequent to the change. Further, Section 140 of the Contract Act deals with the right of subrogation to the surety, which provides that when the surety has paid the guaranteed debt or performed a guaranteed duty, it steps into the shoes of the creditor and all rights of the creditor start to vest with the surety.

The submissions of the Respondent were not recorded in the judgement.

Observations of the NCLAT

The NCLAT observed that one of the primary objects of the Code is maximization of the value of the assets of the Corporate Debtor and then to balance the interest of all the creditors. Further the Code prohibits the promoters from gaining, directly or indirectly, control of the Corporate Debtor, or benefiting from the corporate insolvency resolution process or its outcome. The Code seeks to protect creditors of the Corporate Debtor by preventing promoters from rewarding themselves at the expense of creditors and undermining the insolvency processes. This is evident from the fact that powers of the promoters as the members of the board of directors of the Corporate Debtor are suspended once the resolution process begins and the promoters and shareholders have no right of representation, participation or voting in the meeting of the committee of creditors.

The NCLAT also observed that the personal guarantors who had filed the appeal in the present matter were the promoters, who contributed to the insolvency of the Corporate Debtor. Therefore, a resolution plan that does not envisage a payment of dues to the Appellants in their capacity as promoters /personal guarantors or discharges the liability of the Corporate Debtor as well as successful resolution applicant would not be discriminatory in nature.

The NCLAT also held that the liability of guarantors is co-extensive with the borrower. Also, it was not the intention of the Code to benefit the personal guarantors by excluding exercise of legal remedies available in law to the creditors, to recover legitimate dues by enforcing the personal guarantees, which are independent contracts.

Decision of the NCLAT

The NCLAT held that resolution plan does not discriminate against the promoters/shareholders/personal guarantors and therefore dismissed the appeal filed by the Appellants.

VA View

The NCLAT held that the resolution plan can effectively deny a personal guarantor the right of subrogation enshrined in the Contract Act. It is trite to mention that promoters or related parties are usually the ones who provide personal guarantees to the corporate debtors. It has been observed in some cases, that the promoters are the ones driving a company to insolvency and in such cases, providing a less favourable payment arrangement or, no payment at all under a resolution plan for such promoters compared to other creditors or even shareholders would be far from discriminatory.

This is in line with the spirit of the judgement in case of ***J.R. Agro Industries Private Limited v. Swadisht Oils Private Limited*** *(decided on July 24, 2018)* where the National Company Law Tribunal, Allahabad (**"NCLT Allahabad"**) ordered a modification of a resolution plan that gave priority to the related party financial creditors over the operational creditors. The NCLT Allahabad applied the principle enshrined in paragraph 55 of the UNCITRAL Legislative Guide which specifies that when an organisation owes debts to more than one creditor, the priority scheme established under the applicable law may provide for subordination of certain types of claim: for example, the determination of the priority of related party claims.

Further, the doctrine of equitable subordination also provides that a court can permit the subordination of a controlling shareholder's claims upon debt to those of other bona fide creditors in bankruptcy, if the controlling shareholder has behaved unfairly or wrongly towards the company and its outside creditors. In line with the aforementioned decision of the NCLT Allahabad and the doctrine of equitable subordination, this judgement acts equitably by differentiating the promoters from other creditors and shareholders.

III. Supreme Court: Former employee can be appointed as an arbitrator

The Supreme Court in the case of ***Government of Haryana PWD Haryana (B and R) Branch v. M/s G. F. Toll Road Private Limited and Others*** *(dated January 3, 2019)* held that the Arbitration and Conciliation Act, 1996 (**"Arbitration Act"**) does not disqualify a former employee from acting as an arbitrator, provided there are no reasonably justifiable apprehensions as to his independence and neutrality.

Facts

M/s G. F. Toll Road Private Limited (**"Respondent 1"**) entered into a contract with the Government of Haryana, PWD Haryana (B and R) Branch (**"Appellant"**) for construction, operation and maintenance of Gurgaon-Faridabad Road and Ballabhgarh-Sohna Road on December 12, 2008. The parties further entered into a Concession Agreement dated January 31, 2009 (**"Agreement"**) for the same. Clause 39.2.2 of the Agreement (*Dispute resolution*) is reproduced hereinbelow:

"There shall be a Board of three arbitrators of whom each party shall select one and the third arbitrator shall be appointed in accordance with the Rules of Arbitration of the Indian Council of Arbitration".

Subsequently, disputes arose between the parties and the Indian Council of Arbitration (**"Respondent 2"**) was requested to commence arbitration proceedings by a letter dated March 30, 2015.

The Appellant appointed a retired Engineer-in-Chief, Mr. R. K. Aggarwal, who was a retired employee of the State of Haryana as its nominee arbitrator. Respondent 2, which was conducting the arbitration proceedings, advised the Appellant to reconsider its choice on the grounds that there might be justifiable doubts with respect to his integrity and impartiality. Respondent 1 raised an objection alleging the same.

Consequently, the Appellant requested for a period of 30 days to appoint an alternative arbitrator. However, before the 30 day period was complete, the Respondent 2 informed the Appellant that it had already appointed a nominee arbitrator as well as the presiding officer. The Appellant sought to challenge the above and filed a application under Section 15 (*Termination of mandate and substitution of arbitrator*) of the Arbitration Act before the Chandigarh District Court and an objection under Section 16 (*Competence of arbitral tribunal to rule on its jurisdiction*) of the Arbitration Act before the arbitral tribunal itself. Both these contentions were dismissed. A civil revision petition was also filed by the Appellant before the Punjab and Haryana High Court, which was dismissed. Aggrieved by the judgement of the Punjab and Haryana High Court, the Appellant filed a special leave petition before the Supreme Court.

Issue

Whether a former employee can be appointed as an arbitrator under the provisions of the amended Arbitration Act.

Arguments

The Appellant argued that the appointment of the nominee arbitrator was illegal and contrary to the rules laid down by the Respondent 2. Further, it was argued that since it has been more than ten years since Mr. Aggarwal's retirement, there cannot exist any proclivity or bias. The Appellant cited the judgement of the House of Lords in ***Locabail Limited v. Bayfield Properties [(2002 (1) All ER 465)]*** which stated:

"The greater the passage of time between the event relied on as showing a danger of bias and the case in which the objection is, raised, the weaker (other things being equal) the objection will be."

The Respondent 1 and the Respondent 2 (collectively referred to as the **"Respondents"**) argued that the appointment of Mr. Aggarwal as the arbitrator was inappropriate as he is a retired employee of the Appellant and

that his ability to be fair, just and impartial is dubious. The Respondents also argued that the Arbitration and Conciliation (Amendment) Act, 2015 (**"2015 Amendment"**), which added the Fifth Schedule to the Arbitration Act, enumerates grounds which give rise to justifiable doubts as to the independence or impartiality of arbitrators. Part 1 of the Fifth Schedule of the Arbitration Act states that the impartiality of an arbitrator can be questioned, if:

"The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party."

Observations of the Supreme Court

The Supreme Court in its judgement clarified that even though the 2015 Amendment would not apply in this case as the appointment in question was made before the amendment was passed, the amendment itself does not preclude any person who was an ex-employee from being appointed as an arbitrator. The Supreme Court ruled that the words *"is an"* indicates that the person so nominated is only disqualified if he/she is a present/current employee, consultant, or advisor of one of the parties. It further observed that the words *"other"* indicates a relationship other than an employee, consultant or an advisor and therefore held that the word *"other"* cannot be used to widen the scope of the section to include former employees.

The Supreme Court further stated that the contention raised by the Respondents that there would be bias was not substantiated by any evidence and it could not be objectively determined. It held that mere allegations of bias without a factual matrix supporting the same could not end up disqualifying an arbitrator.

Decision of the Supreme Court

The Supreme Court set aside the earlier judgement of the Punjab and Haryana High Court and stated that the appointment of Mr. Aggarwal was valid. However, during the pendency of the proceedings, both parties mutually agreed to arbitration being conducted by a single arbitrator in supersession of the arbitration clause in the Agreement, and therefore the Supreme Court directed that the sole arbitrator shall proceed in continuation of the previously-constituted arbitral tribunal.

VA View

This judgement of the Supreme Court clarifies an important proposition of law regarding the appointment of a former employee as an arbitrator post the 2015 Amendment. It clarifies that even though the person is a former employee of a party, that in itself cannot disqualify him from being appointed as an arbitrator. Further, the burden to show that the appointed arbitrator cannot exercise his/her mandate without bias or favoritism is firmly placed on the alleging party. It is also clarified that mere allegations are not enough to give rise to justifiable doubts as to the independence or impartiality of an arbitrator under the Fifth Schedule of the Arbitration Act added in the 2015 Amendment and therefore the same should be substantiated by sufficient evidence.

Therefore, this judgement can be construed as a pro-arbitration judgement. However, the courts must be vigilant as bias must be judged on a case-to-case basis, and in cases where there can be an obvious indication of bias, the judiciary must step in to ensure that there is no impropriety.

IV. Supreme Court: 'Administrative difficulties' cannot be a valid reason for condoning the delay in challenging a domestic award beyond the statutory period prescribed

The Supreme Court in the case of ***M/s Simplex Infrastructure Limited v. Union of India*** *(decided on December 5, 2018)* held that administrative difficulties cannot be a valid reason to condone a delay above and beyond the statutory period prescribed under the Arbitration and Conciliation Act, 1996 (**"Arbitration Act"**).

Facts

M/s Simplex Infrastructure Limited (**"Appellant"**), a contractor, entered into an agreement dated January 5, 2006, for the construction of permanent shelters in the tsunami-hit Andaman and Nicobar Islands with the Union of India (**"Respondent"**). Due to differences with regard to the performance of the construction work, the parties were referred to arbitration.

On October 27, 2014, the arbitrator made an award in favour of the Appellant. The Respondent received the copy of the award on October 31, 2014. Aggrieved by the award, the Respondent filed an application under Section 34 (*Application for setting aside arbitral award*) of the Arbitration Act on January 30, 2015 before the District Judge, Port Blair. On February 12, 2016, the District Judge dismissed the Respondent's application for want of jurisdiction. On March 28, 2016, the Respondent filed an application under Section 34 of the Arbitration Act before the Calcutta High Court for challenging the arbitral award along with an application for condonation of a delay of 514 days on ground that there was a bona fide mistake in filing the application before the wrong forum and the Respondent's counsel caused delay due to which necessary formalities were not complied with within the prescribed time. The Calcutta High Court allowed the Respondent's application and condoned the delay. Aggrieved by the decision of the Calcutta High Court, the Appellant filed an appeal in the Supreme Court and the following issue came up for determination:

Issue

Whether the Calcutta High Court was justified in condoning a delay of 514 days by the Respondent in filing the application under Section 34 of the Arbitration Act?

Relevant Provision

Section 34(3) of the Arbitration Act states as follows:

"34. Application for setting aside arbitral award.

(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the arbitral award or, if a request had been made under section 33, from the date on which that request had been disposed of by the arbitral tribunal:

Provided that if the Court is satisfied that the applicant was prevented by sufficient cause from making the application within the said period of three months it may entertain the application within a further period of thirty days, but not thereafter."

Arguments

The Appellant argued that even if the benefit of Section 14 of the Limitation Act, 1963 (**"Limitation Act"**), which deals with the "exclusion of time of proceeding bona fide" in a court without jurisdiction subject to satisfaction of certain conditions, was extended to the Respondent in filing the application under Section 34 of the Arbitration Act, there would still be a delay of 131 days which could not be condoned in view of the specific statutory limitation prescribed under Section 34(3) of the Arbitration Act.

The Respondent argued that delay in filing an application under Section 34 of the Arbitration Act was due to the fact that departmental office was located at Port Blair, Andaman and it was a time-consuming process for obtaining permission from the circle office at Chennai. Hence, there were no willful latches on its part and the delay was caused due to inevitable administrative difficulties of obtaining directions from higher officials. The Respondent in this context relied on the case of ***Union of India v. Tecco Trichy Engineers & Contractors [(2005) 4 SCC 239],*** wherein the Supreme Court condoned the delay of 3 months and 27 days and observed that the service of the arbitral award on the general manager could not be taken to be sufficient notice to constitute the starting point of limitation for the purpose of Section 34(3) of the Arbitration Act.

Observations of the Supreme Court

The Supreme Court examined Section 34(3) of the Arbitration Act which provides that the application for setting aside the award could be made within 3 months from the date of receipt of the arbitral award and the period can only be extended for a further period of 30 days on showing sufficient cause and not thereafter. The Supreme Court observed that the use of the words "but not thereafter" in the proviso makes it clear that the extension cannot be given beyond 30 days. Relying on the case of ***Union of India v. Popular Construction Company [(2001) 8 SCC 470],*** the Supreme Court observed that Section 5 of the Limitation Act (*Extension of prescribed period on sufficient cause*) has no application to the application filed under Section 34 of the Arbitration Act.

The Supreme Court further observed that even if the benefit of Section 14 of the Limitation Act (*Exclusion of time of proceeding bona fide in court without jurisdiction*) in respect of the period spent in pursuing the proceedings before the District Judge is given to the Respondent, there will still be a delay of 131 days in filing the application under Section 34 of the Arbitration Act before the Calcutta High Court which was beyond the strict timelines prescribed under Section 34(3) of the Arbitration Act. The Supreme Court differentiated facts of the present case with the facts of the case relied upon by the Respondent by holding that there is no dispute with respect to the party who received the arbitral award in the instant matter. With regard to obtaining permission from the circle office at Chennai, the Supreme Court observed that administrative difficulties would not be a valid reason to condone a delay above and beyond the statutory prescribed period under Section 34 of the Arbitration Act.

Decision of the Supreme Court

The Supreme Court set aside the judgement rendered by the Calcutta High Court and dismissed the application for condonation of delay filed under Section 34(3)of the Arbitration Act on the ground that it was barred by limitation.

VA View

Strictly interpreting the provisions of law, the Supreme Court in this case, has set aside the application filed by the Respondent beyond the statutory period prescribed under Section 34(3) of the Arbitration Act. While arriving at the conclusion, the Supreme Court laid emphasis on use of words "but not thereafter" in the proviso to Section 34(3) of the Arbitration Act. The said judgment clearly lays down the view that courts should not exercise their powers beyond what has been prescribed in the Arbitration Act as that will only defeat the legislative intent behind the enactment of the said proviso.

Reaffirming its earlier judgement in case of ***Consolidated Engineering Enterprises v. Principal Secretary, Irrigation Department [(2008) 7 SCC 169]*** on applicability of Section 14 of the Limitation Act on the application filed under Section 34(3) of the Arbitration Act, the Supreme Court brought more clarity in computing the period of limitation in challenging an arbitral award. Though this judgment will serve as a precedent in the importance of filing the application within the limitation period prescribed under the law, the Supreme Court has failed to lay down any criteria for determining as to what would constitute an 'administrative difficulty' by the party filing the application for condonation of delay and therefore the same will have to be examined on a case to case basis.

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