Insolvency and Bankruptcy Hotline

September 12, 2017

SUPREME COURT CHOOSES TO INTERPRET THE INSOLVENCY CODE FOR THE FIRST TIME

Supreme Court holds that:

- the Code is exhaustive and will be applicable notwithstanding any other prior law in operation;
- after appointment of interim resolution professional, the directors of the company are no longer in management cannot maintain an appeal on behalf of the company;
- When an insolvency application is made by a financial creditor, the only scope of argument is that the debt is not due for any reason;
- The Code provides for strict timelines which must be given effect to;

Recently, the Supreme Court of India **("Supreme Court")** in *M/s. Innoventive Industries Ltd* **("Innoventive")** *v. ICICI Bank & Anr* **("Respondents")** has passed their first ruling on the newly enacted Insolvency and Bankruptcy Code, 2016 **("Code")**. The judgment provides much needed guidance on how the Code is to be interpreted including in case of a conflict with prior laws, and also opines on the ability of an erstwhile director to file an appeal once an interim resolution professional has been appointed for the company.

BACKGROUND:

Innoventive had proposed to implement corporate debt restructuring as they were not able to service the financial assistance provided by 19 banking entities. Subsequently, on May 23, 2014, a CDR empowered group admitted the restructuring proposal of Innoventive, which was also approved by the joint lenders forum meeting on June 24, 2014. Pursuant to the restructuring plan, a master restructuring agreement was entered into on September 9, 2014, wherein funds were to be infused by the creditors, and certain obligations were to be met by the debtors over the next two years.

BEFORE NATIONAL COMPANY LAW TRIBUNAL ("NCLT"):

ICICI Bank (one of the Respondents) filed an Insolvency Application ("**IA**") on December 7, 2016 against Innoventive, and prayed that the insolvency resolution process ought to be set in motion, in view of the fact that Innoventive was a defaulter under the Code.

Innoventive filed an application in the IA, relying on notifications dated July 22, 2015 and July 18, 2016 under the Maharashtra Relief Undertakings (Special Provisions Act), 1958 **("Maharashtra Act")**, to contend that no dues were legally due. Innoventive assailed that all liabilities, save and except certain liabilities which were not before NCLT, were temporarily suspended for a period of one year under each notification.

In a second application filed on January 16, 2017, Innoventive also contended that funds had not been released under the master restructuring agreement, thereby rendering Innoventive incapable of repaying it's debts.

By an order dated 17 January 2017, the NCLT held that:

a. The Code would prevail over the Maharashtra Act in view of the non-obstante clause in Section 238[1] of the Code;
b. A Parliamentary statute would prevail over the State statute, which meant that the IA could be admitted and moratorium declared;
c. The second application filed by the Innoventive is not maintainable because: (a) no audience has to be given to corporate debtors by the Tribunal under the Code; (b) the plea of funds not being available was not asserted in the earlier application by Innoventive, and in view of the fact that only 14 days are available from the date of filing of the IA to decide existence of a default, such a belated plea of Innoventive could not be considered.

BEFORE NATIONAL COMPANY LAW APPELLATE ("NCLAT"):

An appeal was filed before the NCLAT where the NCLAT upheld the decision of the NCLT but held that the Code and the Maharashtra Act operate in different fields and are not repugnant to each other. NCLAT also held that Innoventive cannot derive any advantage from the Maharashtra Act to stall an insolvency resolution process under Section 7[2] of the Code.

SUPREME COURT:

Aggrieved by the order of the NCLAT, Innoventive preferred an appeal before the Supreme Court contending that:

a. The moratorium imposed by the Maharashtra Act continued to be in force when the insolvency application was filed against Innoventive, and hence the Code would not apply;
b. No repugnancy exists between the two statutes under Article 254 of the Constitution – as has been correctly held by the NCLAT, as both the statues operate in their own fields; while the Maharashtra Act provides for relief against unemployment, the Code provides for a liquidation process.

Research Papers

Littler International Guide (India) 2024
November 08, 2024

Unmasking Deepfakes
October 25, 2024

Are we ready for Designer Babies
October 24, 2024

Research Articles

The Bitcoin Effect
November 14, 2024

Acquirers Beware: Indian Merger Control Regime Revamped!
September 15, 2024

Navigating the Boom: Rise of M&A in Healthcare
August 23, 2024

Audio

Digital Lending - Part 1 - What's New with NBFC P2Ps
November 19, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part I
August 26, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part II
August 26, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

"Investment return is not enough" Nishith Desai with Nikunj Dalmia (ET Now) at FII8 event in Riyadh
October 31, 2024

Analysing SEBI's Consultation Paper on Simplification of registration for FPIs
September 26, 2024

The Respondents contended that:

a. The object of the Code provides that the interests of all stakeholders, i.e. the shareholders, creditors and workmen ought to be balanced during the insolvency process, and the old notion of sick management continuing nevertheless in the management has been debunked by the Code;
b. When an application is made under Section 7 of the Insolvency Code, the only scope of argument is that the debt is not due for any reason;
c. After an interim resolution professional has been appointed and a moratorium is declared, the directors of the company are no longer in management and could not therefore maintain the appeal;
d. Both the statutes are repugnant to each other; while the Maharashtra Act provides for limited moratorium after which the State Government may take over the management of the company, the Insolvency Code imposes a full moratorium automatically the moment an application is admitted by NCLT and thereafter the management of the company is taken over by insolvency professional.

JUDGMENT AND ANALYSIS:

The Supreme Court upheld the contention of the Respondents and dismissed the appeal. While the Supreme Court found substance in the argument that once an insolvency professional is appointed to manage the company, the erstwhile directors (who are no longer in management) cannot maintain an appeal on behalf of the company, the appeal was not dismissed on this ground alone and in fact, chose to deliver a detailed judgment expounding upon the paradigm shift in the law under the Code, for the benefit of courts and tribunals.

The Supreme Court held that the Maharashtra Act was in repugnance with the Insolvency Code and the non-obstante clause in Section 238 of the Insolvency Code will override any non-obstante clause under a State enactment.

While not requiring to do so, the Supreme Court observed that the obligation of the corporate debtor was unconditional and did not depend on infusion of funds by creditors, as was sought to be argued by Innoventive. Laying stress on the need to follow the strict timelines provided under the Code, the Supreme Court noted that this plea was taken by the Innoventive at a belated stage i.e. much after the 14 day timeline provided under the Code to determine existence of a default under Section 7.

This is the first decision of the Supreme Court under the Code, and hence this ruling analyses the key provisions and the rationale behind enactment of the Code, the objectives of the Code and brief comparative analysis of the insolvency and bankruptcy laws in several other jurisdictions.

Reading the non-obstante clause contained in Section 238 of the Code in the widest terms possible and giving impetus to the strict timelines and objects of the Code is praiseworthy and will bring certainty and make it hard for defaulting debtors to take shelter under several prior or state legislations, in order to delay the insolvency process.

Insofar as the Court's view that once an insolvency application is admitted, the Code does not permit erstwhile company directors to maintain an appeal on behalf of the company may lead to an interesting debate as in certain facts and circumstances, where an appeal may well be necessary. This judgment will shut the door on such instances. This view leads to the fact that only the interim resolution professional ("**IRP**") can maintain an appeal on behalf of the company. This contention was raised before the NCLAT in *Steel Konnect (India) Pvt Ltd v M/s Hero Fincorp Ltd,*wherein it was held that an IRP is appointed only upon admission of the IA, and if the same order admitting the IA is to be appealed by the IRP, that will put the IRP in a position of conflict of interest. Further, it was observed that the scope of power of the IRP as provided under the Code does not include the power to initiate proceedings on behalf of the corporate debtor. Also, the directors continue to be in their post and are still present in the records maintained by the Registrar of Companies and are just put in temporary suspension for 180/270 days till continuation of the insolvency resolution process. Further, the IRP may be appointed by the NCLT after 14 days of the insolvency commencement date, during this interim period there can be no appeal to the order of admission of the IA as the directors cannot prefer an appeal and there is no IRP to file an appeal. In light of these issues this particular point may well be discussed in detail in future judgments.

The Supreme Court's emphasis on expediting the insolvency process and ensuring timely recovery of debt will only support the ease of doing business and will, at an intrinsic level, work to build comfort and strengthen the debt markets as well as the recovery process.

– Arjun Gupta, Alipak Banerjee & Sahil Kanuga
You can direct your queries or comments to the authors

[1] Section 238 of the Code: Provisions of this Code to override other laws.- The provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law."

[2] Section 7 of the Code provides the process to initiate corporate insolvency resolution by a financial creditor.

Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996
September 22, 2024