Insolvency and Bankruptcy Hotline

July 28, 2017

NCLT, COURTS AND THE RBI WORK TOGETHER TO IMPLEMENT THE BANKRUPTCY CODE

- Gujrat High Court upholds the RBI Press Note dated June 13, 2017: differential treatment of 12 accounts held to be non-violative of their right to equality;
- Essar Steel's NCLT proceedings to continue despite ongoing attempts to restructure debt;
- The filing of an application under the IBC will not result in a mechanical admission, NCLT to apply judicial discretion;
- NCLT defines scope of Moratoriums under the IBC;

INTRODUCTION

In the most recent development in the ongoing battle against Non-Performing Assets (**"NPA's"**), the Gujrat High Court ("**GHC**") upheld the constitutionality of the RBI Press Note dated June 13, 2017 (**"Press Note"**),[1] compelling Essar to appear in insolvency proceedings before the NCLT.

BACKGROUND

• The Banking Regulation Act, 1949 (**"BRA"**) was amended by way of an Ordinance of the Central Government (**"Ordinance"**). This Ordinance, *inter alia,* empowered the RBI to issue directions to any banking company to initiate the insolvency resolution process in respect of defaults under the IBC. For a detailed analysis of the Ordinance you can access our hotline here.

• On May 22, 2017, the RBI issued a Press Release stating, *inter alia,* that it would be constituting a Committee comprised majorly of its independent Board Members to advise it with respect to concerns regarding large stressed assets. Consequently, on June 13, 2017, the RBI issued the Press Note clarifying that:

i. An Internal Advisory Committee (**"IAC"**) had been appointed, and in its first meeting on June 12, 2017, the IAC arrived at what it called an "objective, non-discretionary" criterion to recommend accounts for resolution under the Insolvency and Bankruptcy Code, 2016 (**"IBC"**);

ii. Accordingly, all accounts with fund and non-fund based outstanding amounts greater than Rs. 5000 Crores, with 60% or more classified as non-performing by banks as of March 31, 2016, were marked out for reference. 12 accounts totaling about 25 per cent of the current gross NPAs of the banking system qualified for immediate reference (**"Identified Accounts"**). The RBI would accordingly issue directions to banks to file for insolvency proceedings under the IBC for the Identified Accounts;

iii. The cases involving the Identified Accounts would be accorded priority by the NCLT;

iv. The NPA's that did not meet the above criteria would be asked by banks to finalize a resolution plan within 6 months ("**Remaining NPAs"**); Please refer to our hotline here for a detailed analysis of the Press Note.

• The Petitioner, Essar Steel India Limited, was one of the Identified Accounts. They approached the Gujrat High Court to challenge (i) the validity of the Press Note; (ii) the decision of the Consortium of Lenders to initiate action under the IBC; and (iii) the Consortium of Lender's failure to implement the restructured debt which had been approved by the Board of Directors of Essar.

ISSUES

- Whether the RBI was within its constitutional mandate while (i) directing the NCLT to accord "*priority*" to certain cases over others; and (ii) directing banks to take action against the Identified Accounts;
- Whether the RBI should have given 6 months to Essar to finalize their ongoing consideration of a resolution plan, like the Remaining NPAs;
- Whether the Press Note is violative of Essar's right to equality under Article 14 of the Constitution of India, 1950.

JUDGMENT

The Gujrat High Court rejected Essar's contentions and held that the Press Note was valid and that in any case, SBI and SCB could approach the NCLT under the IBC independently, regardless of the Press Note.

RBI Corrigendum & Power of the NCLT

The GHC noted that the RBI had in its Press Note directed the NCLT to give priority to any application made in respect of the Identified Accounts. It was observed that adjudicating authorities are not to be guided by government institutions. Keeping that principle in mind, the RBI issued a corrigendum retracting portion of the Press Note which asked the NCLT to accord priority to such applications.

Accordingly, the Court stated that any application filed in respect of the Identified Accounts will not be accorded priority by the NCLT, and will not be presumed to be admitted. The NCLT will be required to extend a hearing and

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reasonable opportunity to Essar to explain why the bank's application should not be entertained. All factual details including any on-going process of restructuring would be duly considered by NCLT before taking any decision on merits. The GHC noted that admission of the application would require the NCLT to exercise its judicial discretion, in accordance with the law and based on the facts, evidence, and circumstance before it.

Constitutional Validity of the Press Note

The GHC clarified that the amended BRA provided RBI with the necessary authority to issue directions to banks for recovery of public money. Further, it was held that the Press Note does not infringe upon any fundamental rights of the Identified Accounts, because it does not create any "*classification*", but merely provides a time schedule for filing proceedings.

Essar Steel's Revival Package

Essar's primary argument was that there was no "*necessity*" to initiate insolvency proceedings against them, because work on a revival package was already underway. Insolvency proceedings, they argued, should be a method of last resort. However, the GHC held that banks had the inherent power to approach the NCLT under the IBC and could do so independently outside the purview of the Press Note, irrespective of whether there existed any endeavor to restructure the outstanding debt. Therefore, banks could not be stopped from filing an application against Essar just because a process of restructuring was currently underway. The GHC also noted that Essar had an admitted debt of more than Rs. 45,000 Crores.

NCLT'S ENDEAVOURS UNDER THE IBC

In the recent past, the NCLT has also passed some crucial orders to stop any misuse of the provisions of the IBC and to implement its provisions as per the letter and spirit of the Code.

Leo Duct Engineers and Consultants Ltd.[2]

The corporate debtor in this case, Leo Duct Engineers and Consultants Ltd. (**"Leo Duct"**) had been unable to liquidate their outstanding liabilities of about Rs. 32 crores towards their financial creditors. Thereafter, Leo Duct filed an application with the NCLT to initiate corporate insolvency resolution process (**"CIRP"**) under Section 10 of the IBC. Admission of the application by the NCLT would necessarily result in initiation of moratorium under section 14 of the IBC. The moratorium would prevent the continuation or initiation of any proceedings against Leo Duct including but not limited to proceedings under the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (**"SARFAESI Act"**). The financial creditors of Leo Duct had already initiated proceedings under the SARFAESI Act which were considerably in the advanced stages of fructification. The secured assets of Leo Duct were due to be repossessed by the financial creditors on the day of filing of the application. The issue was whether in the factual scenario, the application initiating CRIP could be admitted, resulting in the initiation of moratorium and thereby scuttling the process of recovery under the SARFAESI Act.

The NCLT stated that under the SARFAESI Act, a bank could proceed against any security provided by either the promoter/guarantor or the corporate debtor. However, personal properties of the promoter/guarantor do not fall within the purview of the IBC. The resolution professional is concerned only with the assets of the corporate debtor or any immovable property in its name and yet a moratorium under Section 14 automatically stalls all proceedings that involve the assets of the debtor as well as the personal property of the promoter/guarantor. Thus, a guarantor could use the moratorium under the IBC to scuttle SARFAESI Act proceedings and avoid being dispossessed of their personal immovable properties.

Noting this, the NCLT held that Leo Duct was merely using this application as a dilatory tactic to scuttle the proceedings under the SARFAESI Act. It was noted that admitting the application would have a serious impact on the financial creditors, who had already set the wheel in motion to recover their debts. Leo Duct was evidently trying to abuse the process of law, to which the NCLT could not be party. Accordingly, the application was dismissed.

Unigreen Global Private Limited[3]

The corporate debtor in this case, Unigreen Global Pvt. Ltd. ("**Unigreen**") filed an application with the NCLT to initiate CIRP. Their outstanding liabilities were in excess of Rs. 100 crores. The issue was whether the CIRP application could validly be admitted.

The creditor-bank argued that Unigreen (directly and through its aides) had merely engineered several civil suits, and kept them pending, to sustain possession of the properties that were otherwise mortgaged and could be taken possession of by the creditor. Unigreen had also filed a suit under Section 17 of the SARFAESI Act against the sale of the mortgaged properties.

The NCLT observed that admission of the CIRP application would induce a moratorium on all other legal actions. Consequently, the creditor-banks would unjustly be stayed from taking possession of the secured assets for a period of at least six months. The NCLT opined that this seemed to be the wrongful intention of Unigreen, and that the Tribunal would not support any such mala fide actions of corporate debtors. They accordingly dismissed the CIRP application and imposed a penalty of Rs. 10,00,000/- on Unigreen and its directors under Section 65 of the IBC.

Schweitzer Systemtek India Private Limited[4]

The corporate debtor in this case, Schweitzer Systemtek India Private Limited ("**SSI**") filed an application with the NCLT to initiate CIRP. SSI claimed that the moratorium under the IBC would prevent the creditor-banks from taking over possession of their secured property. The creditor-banks, on the other hand, argued that this was SSI's attempt to thwart their attempts to recover the property.

The Tribunal recognized that the imposition of moratorium on legal proceedings against the corporate debtor under the IBC has been used to frustrate recovery proceedings in certain cases. The IBC states that a moratorium is to be declared to "*prohibit any action to recover or enforce any security interest created by the Corporate Debtor in respect of its property*". The Tribunal noted that the "*its*" herein refers to the Corporate Debtor. Accordingly, the moratorium would prohibit action against properties reflected in the Balance Sheet of the Corporate Debtor, but not any other properties beyond its ownership. Thus, it was clarified that proceedings under the SARFAESI Act may fall within the ambit of the moratorium *only* if the action is to foreclose or to recover or to create any interest in respect of the

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property belonging to or owned by a Corporate Debtor. The Application was therefore admitted, subject to this exception. Therefore, by implication any property which belongs to the promoter/guarantor of a corporate debtor can be proceeded against by a bank or a financial institution under the SARFAESI Act to recover its outstanding dues even during the pendency of proceedings and continuation of moratorium under the IBC.

ANALYSIS

The insolvency resolution process in India has been inefficient because of the segregated legal system and the overburdened judiciary. The Bankruptcy Code and the NCLT were envisaged to act as two sides of a double-edged sword in tackling the problem of stressed assets in our economy and increasing the efficiency of insolvency resolution.

The legislature had passed the Bankruptcy Code with the aim of increasing the ease of doing business in India. Consequent amendments to other acts like the BRA by way of the Ordinance have further strengthened this stance. Regulatory authorities like RBI have joined the fight and given teeth to this legislative intent.

It was important that these novel and well-intended measures were interpreted and implemented in a constructive manner by the various adjudicatory authorities. From the above judgments, we can see that the GHC and the NCLT has done a commendable job in interpreting the spirit and letter of the Bankruptcy Code in a harmonious manner with the legislative and regulatory intent. One of the biggest roadblocks for efficient resolution of disputes in India is the general attitude of litigants which is extremely adversarial and using dilatory tactics to defeat the purpose of law is more the norm than exception. The GHC and the NCLT have dealt a heavy blow to such dilatory tactics which should act as a deterrent for any such future misadventures.

The bare text of the provisions analyzed in this hotline can be found here.

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

[1] Essar Steel India Ltd. ("**Essar**") v. Reserve Bank of India (**"RBI"**), State Bank of India (**"SBI"**), Standard Chartered Bank (**"SCB"**), and the National Company Law Tribunal (**"NCLT"**), Special Civil Application No. 12434/2017

[2] 1103/I&BP/NCLT/MAH/2017

[3] C.P NO. (IB)-39(PB)/2017

[4] T.C.P. NO.1059/I&BP/NCLT/MB/MAH/2017