THE LEGALITES LEXSCRIPTA

ISSN 3108-2416 (ONLINE)

Editor-in-Chief: - Prof. (Dr.) Aryendu Dwivedi

Volume II Issue II (April-June) Page No.: - 274 to 283

CREDITOR INITIATED INSOLVENCY UNDER IBC, 2016: A CRITICAL ANALYSIS

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ABSTRACT

Insolvency and Bankruptcy Code, 2016 marks a historical milestone in the evolution of laws relating to corporate insolvency resolution in India. Within a period of less than a decade from its passage, the Code has brought about a paradigm shift in the manner in which corporate insolvencies in India are resolved, having replaced the previous fragmented, inefficient, and cumbersome regime with a more unified, time-bound, and creditor-centered model that has gained international acclaim. With regard to the key role played by creditors under the Code's creditor initiated insolvency framework, the creditors have been provided the necessary tools and incentives to become actively engaged in the process of resolving corporate insolvency, which has had far-reaching implications for the creditor debtor dynamic in India. The inspiration behind this research work is the author's intense fascination with the developing jurisprudence of the IBC along with an acknowledgment of the challenges and issues that arise out of the creditor initiated insolvency framework that, despite its novelty and ingenuity, has not escaped academic scrutiny. Among these issues, discrimination between financial and operational creditors emerges as one of the most debated and crucial aspects of the Code.

Non-refoulement – defined and discussed through the course of this research as being the key norm underpinning refugee protection – is a clear example of the resilience and weakness inherent in the current system. The development of non-refoulement as a rule of customary international law – and potentially peremptory norm – demonstrates the key role played by the principle in the system. However, current practices of pushbacks, externalization, and offshore processing suggest efforts on the part of states to circumvent rather than violate the norm in question. Undertaking research for the purpose of this paper was an extremely enlightening and professionally enriching experience for the author. Studying the statutory provisions of the IBC, examining the fast-growing body of judicial interpretations of the new Code by various courts in India, and analyzing the insolvency regimes of different jurisdictions provided me with a thorough and multi-faceted insight into the issue. It is the goal of the present study to

address various challenges faced during the course of the research without undermining the impressive accomplishments made possible through the IBC.

It is clear to the author that insolvency law is an area which is changing fast, and thus some of the matters which have been addressed in this research might become out-of-date due to future legislation amendments or court decisions. The opinions expressed in this research paper are only those of the author and should not be taken to represent the opinions of any organization or person.

Keywords: Insolvency and Bankruptcy Code, 2016 (IBC), Corporate insolvency resolution, Creditor-initiated insolvency, Creditor-driven framework, Financial creditors, Operational creditors, Differential treatment of creditors, Corporate distress, Creditor-debtor relationship, Judicial jurisprudence, Time-bound resolution

INTRODUCTION

The Committee on Bankruptcy Law Reforms (BLRC), headed by Dr. T.K. Viswanathan in 2014, carried out an exhaustive study of the gaps within the existing insolvency regime and proposed the creation of an integrated legislative framework for dealing with insolvency and bankruptcy of both corporate and individual debtors. The BLRC Report, submitted in November 2015, has provided the conceptual and structural basis for the IBC, advocating a creditor-focused approach based on a time-bound resolution procedure where going-concern value takes precedence over asset realization. It is important to note that an effective insolvency law needs to cater to two basic functions – one, that of maximizing the value of assets of the debtor and second, an equitable distribution of assets among creditors based on an established priority system.

The IBC Act was enacted by both Houses of Parliament and received the President's assent on 28 May 2016. In the seminal decision of Swiss Ribbons Pvt. Ltd. v. Union of India, the Supreme Court of India has held that the IBC Act is constitutional and has been enacted with an objective to solve the issue of corporate distress in a time-bound manner while harmonizing the interest of all stakeholders.3 As per the Supreme Court, the IBC Act is a comprehensive legislative framework for dealing with the issues of insolvency resolution pertaining to corporate bodies, partnership firms, and individual entities in a time-bound manner, and the provisions of the said Act constitute a fine legislative scheme intended to facilitate business, foster entrepreneurship, and recover dues of creditors.

One of the key aspects of the IBC is the focus on the initiation of the process by the creditors. Under the old regime, the insolvency process was marked by the use of debtor in possession models where the management of the distressed firm remained in control of the operations of the firm, at the expense of the creditors' interests. The IBC completely revolutionised this aspect by introducing a creditor in control model, whereby the creditors, financial or

operational, have the ability to initiate the Corporate Insolvency Resolution Process (CIRP) against the defaulting corporate debtor.

Research Objectives

The present research shall be premised on the following research aims:

First, to undertake a study of the historical development of insolvency law in India, and the underlying legislative rationale behind the enactment of the Insolvency and Bankruptcy Code, 2016, taking into consideration the transition from debtor-oriented insolvency regime to creditor oriented insolvency paradigm.

Second, to carry out an examination of the legal framework governing the institution of Corporate Insolvency Resolution Process by financial creditors under Section 7 and by operational creditors under Section 9 of the IBC, in light of the procedures and criteria for filing, evidence requirements and thresholds laid down in the Code and its subsidiary legislation.

Third, to evaluate the discriminatory treatment of financial and operational creditors in the institution, conduct and resolution of the CIRP, and examine whether such discrimination is constitutionally acceptable, doctrinally sound and practically justifiable.

Fourth, to conduct a detailed analysis of judicial interpretation of relevant provisions relating to creditor-initiated insolvency as made by the Supreme Court of India, NCLAT, and NCLT.

Research Questions

The following research questions have been put forward as part of this study:

Is the current system of international refugee protection sufficient to deal with modern-day displacement problems?

In what ways do international refugee laws and human rights laws complement each other when it comes to protecting displaced people?

How effective are the institutional frameworks used in implementing refugee protection?

Why is the current legal framework unable to tackle climate-based displacement?

What kind of reform is needed for an enhanced international refugee protection regime post-2025?

Methodology of Research

The current research project makes use of a doctrinal methodology, which is further enhanced through an analytical, comparative, and evaluative approach. As per the methodology of

doctrinal research, there will be a systematic analysis and interpretation of the primary sources of law, such as the Insolvency and Bankruptcy Code, 2016, amendments made thereto, secondary legislation including regulations issued by the Insolvency and Bankruptcy Board of India, and Rules issued by the Central Government. Analysis will also include judicial decisions rendered by the Supreme Court of India, National Company Law Appellate Tribunal, and National Company Law Tribunal.

Introduction

The doctrine of insolvency forms the basis of the legal system that governs the commercial and economic affairs within capitalist societies. In the general sense, insolvency describes the state of financial inability of an individual or entity to pay off their debts. The treatment of insolvency through legal mechanisms has come a long way from debtor incarceration systems of earlier ages to the complex structures that govern modern insolvency regulations. This aims to study the core principles of insolvency law, examine the development of the insolvency regime in India, and explore the principles behind the creditor-based insolvency regime of IBC.

Definition of Insolvency: Theoretical Dimensions

Insolvency can be understood in multiple ways depending upon the legal system and academic discipline that has defined it. In general parlance, insolvency refers to the state wherein the debtor lacks the ability to discharge debts as they fall due (‘cash-flow’ or ‘commercial’ approach), and where the value of total liabilities exceeds the value of total assets (‘balance sheet’ approach).13 While both approaches have their own relevance, each of them comes with distinct implications. In the former approach, the liquidity situation of the debtor is examined, while in the latter approach, the overall solvency situation of the debtor is considered in terms of asset-liability valuation.

The IBC takes the approach of default-based initiation of the CIRP, instead of adopting the cash-flow or balance-sheet approach in its strict sense. As per the Code, any ‘default’ constitutes the necessary and sufficient condition for the commencement of insolvency proceedings by the creditor.14 The default-based initiation of the CIRP is a deliberate choice made by the legislature, having been guided by the BLRC’s observation that the standard of default-based initiation is relatively more objective, transparent, and administrable compared to cash-flow and balance-sheet standards.

It is essential that we draw a line between insolvent and bankrupt in the sense that they have two different definitions even though people tend to use the two terms interchangeably at times. Under the IBC, insolvent means the process of resolving issues relating to the financial affairs of an insolvent corporation using a resolution plan. The term bankrupt, on the other hand, is used to refer to the final stage of this process where the assets of a debtor are disposed of amongst his/her creditors. The latter is especially applied to individuals and partnerships under Part III of the Code.

Historical Evolution of Insolvency Law in India

Insolvency law in India has developed in an incremental and piecemeal manner over time due to legislation passed during the period of British rule, post-colonial economic reforms, and the requirements of a swiftly modernizing economy. The early legislation dealing with the subject of insolvency in India was the Presidency Towns Insolvency Act of 1909 and the Provincial Insolvency Act of 1920 that only focused upon the insolvency of individuals, with the former being drafted after taking inspiration from English insolvency laws.16 Both legislations, while relevant in their context, catered to an agricultural society and fell short of requirements regarding insolvency of companies.

The provisions for winding up found within Sections 433 to 560 of the Companies Act, 1956 were the primary legal provision in place for resolving insolvency cases of companies after the independence of India. However, this winding up provision under the Companies Act was more focused towards liquidating assets rather than considering the prospect of rescue or rehabilitation of the company in question as a whole. In fact, the procedure for winding up a company was known for its lengthy nature, often extending into multiple decades.

The awareness of the potential danger posed by industrial sickness to the Indian economy resulted in the passage of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA). This law provided for the creation of the Board for Industrial and Financial Reconstruction (BIFR), an organisation designed to detect, prevent, and remedy industrial sickness.18 Although SICA was a recognition in legislation of the importance of corporate rehabilitation, the BIFR approach had serious flaws, including a lack of timely intervention, inadequate enforcement mechanisms, and the tendency to side with the debtors and their promoters against the creditors. There were many cases where unscrupulous promoters abused the BIFR system by using it as a cover-up to avoid legal action from their creditors.

The opening up of the Indian economy in 1991 followed by the growth of the banking and finance sector made it imperative to create new mechanisms for the recovery of debts due to banks and financial institutions. The RDDBFI Act provides for setting up Debt Recovery Tribunals (DRTs) for adjudication and speedy recovery of debts due to banks and certain financial institutions.19 But even the DRT procedure could not be adequate to deal with the problems of non-performing assets and therefore the SARFAESI Act, 2002 gave secured creditors the power to enforce their security interest outside the purview of court proceedings.20 But still, despite these measures being taken by way of amendments, the insolvency law of India remained fundamentally fragmented as there were several statutes relating to the same aspect of the law, each dealing with the issue from its own angle, resulting in procedural conflicts among different statutes. Several expert committees appointed to review the law on insolvency and make recommendations in that regard such as the Eradi Committee (2000) and N. L. Mitra Committee (2001) recommended the need to have an integrated insolvency legislation.

The Genesis of the IBC: From BLRC to Legislation

The primary reason behind the formation of the IBC was the creation of the Bankruptcy Law Reforms Committee (BLRC) in August 2014 headed by Dr. T.K. Viswanathan, who at that time held the position of Secretary General of the Lok Sabha. The Bankruptcy Law Reforms

Committee conducted a thorough analysis of the Indian system of insolvency and bankruptcy laws, and delivered its comprehensive report in November 2015. This report pointed out four critical flaws in the existing insolvency system in India: first, the lack of an appropriate collective insolvency resolution regime to maintain the ongoing business value of the entity; second, the overlap of various legislations; third, the lengthy period required for resolution of insolvency cases; and finally, insufficient protection of the rights of creditors.

BLRC proposed a need to enact an integrated Insolvency and Bankruptcy Code, which would not only replace the plethora of existing laws, but would also ensure a coherent institutional architecture including the NCLT as the adjudicator of corporate insolvency cases, the IBBI as the regulator, insolvency professionals and insolvency professional agencies as crucial participants in the process, and information utilities for holding financial information. Further, the committee suggested the inclusion of certain features such as a creditor-based approach, time-bound process, and resolution of corporate stress as a going concern. Liquidation is seen as a measure of last resort. The Insolvency and Bankruptcy Bill was introduced in Lok Sabha in December 2015, and was sent to the Joint Committee of Parliament for consideration. The report of the Joint Committee, which was presented in April 2016, accepted the basic structure of the Bill, but proposed some amendments to improve procedural protection for the benefit of various stakeholders.24 The Insolvency and Bankruptcy Bill, as amended by the Joint Committee, was passed by Lok Sabha on 5 May 2016 and Rajya Sabha on 11 May 2016, and received the Presidential assent on 28 May 2016. The IBC was enacted in stages, and the provisions

Creditor-debtor Power Relationship under IBC

In essence, the IBC radically transforms the nature of power that exists between the debtor and the creditor, making the former subordinate to the latter. As per the earlier legal framework, the debtor-in-possession system gave the management of the insolvent entity the authority to manage their affairs when insolvency proceedings were going on. This often led to the waste of resources, favoring of insider creditors, and lengthening of the process itself.

The provisions of the IBC have overcome the above shortcomings through the creation of a mechanism which provides for the appointment of the Interim Resolution Professional (IRP) following the admission of the application for CIRP, along with the changeover of control from the corporate debtor's board of directors and the promoters to the IRP and later to the Resolution Professional (RP), who is appointed by the Committee of Creditors. Thus, the moratorium imposed by Section 14 of the Code ensures that no proceeding shall be initiated or continued against the corporate debtor during CIRP proceedings. It, therefore, creates a 'breathing space' for the resolution proceedings free of any disruptions caused by separate suits against the corporate debtor. On the other hand, the introduction of the creditor-in-charge scheme gives rise to some doubts concerning the rights of other stakeholders such as the employees, operational creditors, and the promoters of the corporate debtor. The Indian Supreme Court, in Swiss Ribbons, had ruled on this matter by stating that the classification between the financial and operational creditors under the Code was done on the basis of the intelligible differentia. The difference was rationally related to the purposes of the law.

Pioneer Urban Land and Infrastructure Ltd. vs. Union of India was another landmark case wherein the legality of the insolvency scheme initiated by the creditor was analyzed. The Apex Court affirmed that the homebuyers could be classified as 'financial creditors' since the classification made by the legislature was in furtherance of the legislative intent to effectuate effective insolvency resolution.

Introduction to CIRP

Filing of the Corporate Insolvency Resolution Process (CIRP) by the financial creditors is among the most significant and often used instruments in the context of the Insolvency and Bankruptcy Code, 2016. Pursuant to Section 7 of the Code, a financial creditor or more than one financial creditors collectively have the privilege of filing a petition with the Adjudicating Authority (National Company Law Tribunal) for the CIRP against the corporate debtor who has defaulted in the payment of the financial debt. The legislative intent underlying Section 7 highlights the significance of financial creditors in the insolvency resolution regime envisaged under the Code, which, according to the Supreme Court, stems from the character of the relationship between the financial creditor and the corporate debtor and the ability of the former to evaluate the economic sustainability of the latter.

In this I will attempt an exhaustive examination of the regulatory regime surrounding the filing of CIRP by financial creditors through a close reading of the relevant statutes, procedures involved, evidential standards to be maintained, the role of information utilities, and the jurisprudence developed in the matter of applications filed under Section 7. We will also examine the unique aspects of the right to initiate CIRP by financial creditors vis-à-vis that of operational creditors as enshrined in Section 9.

Judicial Interpretation And Case Law Analysis

The judiciary has been very important in determining the nature of creditor initiated insolvency proceedings under the IBC. With the enforcement of the Code from December 2016 onwards, a lot of judicial precedents have been set by the Supreme Court of India, NCLAT, and NCLT benches interpreting, developing, and in certain cases revising the provisions related to the filing of and process in a CIRP. This chapter presents a thorough discussion of the landmark judgements on the subject of creditor initiated insolvency proceedings.

The Foundational Decision: Innoventive Industries

The judgment of the Supreme Court in the case of Innoventive Industries Ltd. vs. ICICI Bank is the first legal exposition regarding Section 7 of the IBC.75 This case emanated from a petition by the ICICI Bank as a financial creditor for the initiation of the CIRP against the corporate debtor (Innoventive Industries Ltd.) who was in default to meet his financial obligations. The corporate debtor contested the petition on the basis that he had sought relief under the Maharashtra Relief Undertakings (Special Provisions) Act, 1958.

The Supreme Court, in the judgment rendered by Justice R.F. Nariman, rejected the plea advanced by the corporate debtor, stating that the non-obstante clause incorporated in Section 238 of the IBC supersedes all contrary provisions contained in any statute, whether state

legislation or otherwise, relating to moratorium or stay of recovery of debts. The Court went ahead to lay down the fundamental proposition that in order to admit the application under Section 7 of the IBC, the Adjudicating Authority is bound only by two factors: the presence of a financial debt and the presence of a default. This section was compared to Section 9 and found to be different in the sense that Section 9 envisaged a requirement of lack of dispute to admit the application whereas Section 7 did not.

Constitutional Validity: Swiss Ribbons

The judgment of the Supreme Court in the case of Swiss Ribbons Pvt. Ltd. v. Union of India constitutes the most thorough judicial analysis of the constitutionality and statutory scheme of the IBC.76 This case consisted of a bundle of writ petitions contesting certain provisions of the IBC for being inconsistent with the fundamental rights enshrined under Articles 14, 19, and 21 of the Constitution of India.

In a landmark judgement delivered unanimously by the Supreme Court, the validity of the entire IBC was upheld, answering each of the questions raised by the petitioners. Specifically speaking, the matter of relevance to the current study would be the manner in which the issue relating to discriminatory treatment of the two categories of creditors, i.e., financial and operational creditors, was addressed by the court. In the matter, it was found that the classification was made on the basis of an 'intelligible differentia' with a nexus with the objectives of the code. Several distinguishing factors were pointed out by the court that made the distinction possible: first, the kind of debts owed (debt against time value of money vs. debts on account of goods/services provided), second, the information gap (the financial creditors would be aware of the financial standing of the debtor on account of their due diligence process), third, the stake in the matter (interest in successful restructuring owing to being a major creditor), and fourth, the ability to judge the viability of the matter.

Furthermore, the Court pointed out that excluding the operational creditors from the CoC would not be violative of Article 14 since the operational creditors were assured of receiving minimum payments under Section 30(2)(b), and they had the right to attend the CoC meeting but only as non-voting members. Moreover, the Court pointed out that there was no possibility of the operational creditors being discriminated against during the resolution process since the NCLT had the authority to ensure that the resolution plan complied with the provisions of the law.

The Essar Steel Decision: Creditor Rights and Resolution Plans

The verdict of the Supreme Court in the case of Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta is often considered to be one of the most important decisions made under the IBC, as it has serious ramifications in terms of how various categories of creditors are dealt with during the course of the resolution process.77 This particular case pertains to the CIRP of Essar Steel India Ltd., which happens to be one of the biggest and most complicated cases of corporate insolvency in India.

It was stated in this regard that the CoC had the right and power to distribute the resolution value in favor of the different classes of creditors in accordance with the soundness of its

commercial decision within the framework of the minimum conditions laid down in Section 30(2). Moreover, it was emphasized by the Court that the NCLT could only have the power of judicial review in relation to the resolution plan, and its review should be confined to the compliance of the resolution plan with the mandatory requirements set forth under the Code, and the NCLT could not take the place of the CoC in making its commercial decision.

Notably, the Court also considered the issue of the equitable treatment of operational creditors, where the Court stated that while there is no requirement in the Code to provide the same treatment to financial and operational creditors, there should be at least the liquidation value paid to the operational creditors. In many cases, it was observed that operational creditors had been receiving amounts more than the liquidation value. Even the restructuring plan adopted in the case of Essar Steel ensured adequate provision for payments to the operational creditors. Nevertheless, the Court pointed out that the issue still required attention, and hence the legislature was encouraged to take further action.

Conclusions

The enactment of the Insolvency and Bankruptcy Code, 2016 has revolutionized the process of insolvency resolution in India. The provision for the initiation of an insolvency proceeding by the creditors, combined with a timely resolution procedure, an appropriate institutional structure, and a regulatory regime, has successfully overcome many of the drawbacks that existed prior to the enactment of IBC and has also made substantial contributions towards the improvement of India's ranking in the Ease of Doing Business Index.

Nevertheless, the analysis carried out in this dissertation highlights some of the drawbacks associated with the insolvency regime initiated by the creditor, which have been brought to light by the implementation of the Code in practice. The distinction between financial creditors and operational creditors, despite being constitutional, poses issues related to fairness and justice, especially for small and medium operational creditors, who do not have the means to bear the cost associated with the insolvency of the entity they lent to. The delay in the CIRP process, the low recovery rate, insufficient institutional strength of the NCLT, and the lack of frameworks for dealing with cross-border and group insolvency cases pose serious challenges to the implementation of the Code.

The recommendations proposed for reforms within this chapter have been made with the intention of being practical, incremental, and relevant to the concerns highlighted in the analysis. The continued evolution of the Insolvency and Bankruptcy Code (IBC) through legislative changes, regulation modifications, and judicial interpretation is an indication of the flexibility and dynamism inherent in the system and it would be safe to be cautiously optimistic about the possibility of resolving some of the challenges highlighted in this dissertation through reform efforts. Ultimately, the effectiveness of the Insolvency and Bankruptcy Code will depend on whether the code will be able to strike a balance between the interests of all parties involved in a fair and equitable manner, which will be in the best interest of the Indian economy as a whole.

The debtor-insolvency regime provided by the IBC constitutes a significant innovation in terms of law reform. Further improvement of this scheme on the basis of practical experience, comparative analysis, and changes in economic reality will help to ensure that the potential of this legislation is realized in full.

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