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ARTICLE

Essar Steel India Limited: Supreme Court Reinforces Primacy of Creditors Committee in Insolvency Resolution

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Synopsis

The *Essar Steel* judgment of the National Company Law Appellate Tribunal (NCLAT), which required that the secured financial creditors share recoveries in a resolution plan under the Insolvency and Bankruptcy Code, 2016 (IBC), *inter se* (irrespective of the ranking of their security positions) and with the trade creditors, on a *pari passu* basis, was described as leading to a 'confusion in the treatment of different types of creditors' and a setback for the nascent but growing secondary debt market in India. The judgment was perhaps also opposed to the realities of credit risk assessments and pricing of the credit leading to an unsatisfactory resolution outcome for creditors in an insolvency situation.

In a landmark judgment on 15 November 2019, a three-judge bench of the Indian Supreme Court in *Essar Steel*[2] set aside most of the NCLAT's judgment and has given much needed clarity to the stakeholders. Some of the key principles laid down by the Hon'ble Supreme Court and their implications on the current insolvency regime are dealt with below.

Reinforcing primacy of commercial wisdom of the committee of creditors

The Supreme Court has re-emphasised the primacy of the commercial wisdom of the committee of creditors (CoC) in relation to resolution of the corporate debtor as was held in its earlier decision in *K. Sashidhar.*[3] Statutorily, prior to approving the resolution plan, the CoC is required to assess the '*feasibility and viability*'[4] of a resolution plan. The Supreme Court observed that such an analysis is required to take into account 'all the aspects of the resolution plan, including the manner of distribution of funds among various classes of creditors'. In this regard, the CoC is free to suggest a modification to the commercial proposal (including for instance, payment to a certain type of operational creditor) on a case-to-case basis, which can have a bearing on the distribution proposed and the commercial proposal. Interestingly, while the commercial wisdom has been accorded primacy, it has also been specified that the CoC does not act in any fiduciary capacity to any group of creditors, rather it is to take a business decision by the requisite majority, which will be binding on all the stakeholders of the corporate debtor.

Scope of judicial review

A strong emphasis has been placed on the fact that a limited judicial review is permissible in respect of any CoC decision. Further, there is no residual equity jurisdiction in the National Company Law Tribunal (NCLT)/ NCLAT to interfere in the merits of a business decision taken by the requisite majority of a CoC, provided that it is otherwise in conformity with the provisions of the IBC and the regulations.

In interpreting the scope and ambit of limited judicial review, the Supreme Court, while holding that operational creditors and dissenting financial creditors are entitled only to their notional liquidation value and not more, placed emphasis on the fact that although the ultimate discretion of what to pay and how much to pay *each class or subclass of creditors* is with the CoC and that the CoC has complete flexibility in this regard, the NCLT has to see that the CoC decision reflects the following key features of the IBC being taken into account:

(a) the corporate debtor needs to continue as a going concern during the insolvency resolution process;

(b) it needs to maximise the value of the assets of the corporate debtor; and

(c) interests of all stakeholders, including operational creditors have been taken care of.

If the said parameters have not been adequately considered, the NCLT may send the resolution plan back to

Notes

1 The authors thank Ms. Surbhi Pareek, Senior Associate, for her assistance on this article. Views are personal and not of the firm.

2 *Committee of Creditors of Essar Steel India Limited v Satish Kumar Gupta & Ors.* (Civil Appeal No. 8766-67 Of 2019).

3 *K. Sashidhar v Indian Overseas Bank* 2019 SCCOnline SC 257.

4 Section 30(4) of the IBC.

the CoC to re-submit such plan after satisfying the said parameters.[5]

The above determination by the Supreme Court clears the uncertainty around the questions pertaining to the ability of NCLT and NCLAT to amend or modify the commercial proposals put forth by the resolution applicants and would possibly reduce multiple litigation by various stakeholders, such as dissenting financial creditors and operational creditors. At the same time, before approval of the resolution plan, the CoC would be required to provide a detailed commercial reasoning for accepting the proposal and distributing proceeds in a particular manner, specifically, how payments are contemplated to operational creditors (in addition to their liquidation value entitlement) to keep the corporate debtor a going concern, in the absence of which the resolution plan may be subject to judicial review.

Secured and unsecured creditor: equally or equitably?

One of the prominent question of law settled by the Supreme Court pertains to the treatment accorded to different classes of creditors, such as operational and financial creditors, secured and unsecured creditors, etc. The NCLAT in its various orders has placed reliance on the principle of equality and held that there is no distinction between secured and unsecured financial creditors or financial creditors and operational creditors in terms of amount proposed to be paid under a resolution plan.

The Supreme Court held that a bankruptcy code 'should not be read so as to imbue creditors with greater rights in a bankruptcy proceeding than they would enjoy under the general law, unless it is to serve some bankruptcy purpose.' It has been further laid down that to pass the muster of law what is required to be seen is that 'equitable treatment' is accorded to 'similarly situated creditors' depending upon the class to which it belongs: secured or unsecured, financial or operational. Rightly so, it has been observed that 'the equality principle cannot be stretched to treating unequals equally, as that will destroy the very objective of the IBC – to resolve stressed assets'. To reiterate, the Supreme Court held that the CoC in its commercial wisdom may approve a plan (with requisite majority) which provides for 'differential payment to different class of creditors, together with negotiating with a prospective resolution applicant for better or different terms which may also involve differences in distribution of amounts between different classes of creditors'[6].

It is also important to note that the court has relied on Form H of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016 to identify the different classes that may be specified in a resolution plan, i.e. dissenting secured and unsecured financial creditors, other secured and unsecured financial creditors, operational creditors and other debts and dues. It was also clarified that creditor-wise recovery need not be included in the resolution plan and a class-wise distribution is compliant. Additionally, the Supreme Court also upheld the CoC's ability to distinguish between secured financial creditors based on the value of their respective security interests.

'Fair and equitable' requirement

The amendments to the IBC in August 2019 appeared to have introduced a new requirement of resolution plans being 'fair and equitable' in addition to the other requirements of Section 30(2). However, the parameters for a plan being fair and equitable were not defined. The question arose as to whether this is a deeming requirement or an additional ground for review. The Supreme Court circumscribed the scope of review by the NCLT/NCLAT by holding that 'it is clear that there is no residual jurisdiction not to approve a resolution plan on the ground that it is unfair or unjust to a class of creditors, so long as the interest of each class has been looked into and taken care of.' It is relevant to note that 'fair and equitable' is a benchmark in many jurisdictions such as UK and the USA for schemes and restructuring plans. However, India, with this decision, has gone for market and creditor driven outcomes.

Disputed and claims not proved – 'fresh slate' start for the corporate debtor

Settling two further legal issues of significance, the Supreme Court also held that while the RP is required to collect, collate and admit claims; if the claims are not capable of being quantified say on account of an ongoing dispute, it is acceptable for the RP to admit claims at a notional value.

The Supreme Court very helpfully emphasised the 'fresh slate' that a resolution applicant desires and held that all claims filed by the RP including disputed claims can be dealt in the plan and the creditors cannot thereafter re-agitate the claim and held as follows:

> 'A successful resolution applicant cannot suddenly be faced with "undecided" claims after the resolution plan submitted by him has been accepted as this would amount to a hydra head popping up which

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5 *Supra* note 2 at para. 46.
6 *Supra* note 2 at para. 56.

> would throw into uncertainty amounts payable by a prospective resolution applicant who successfully take over the business of the corporate debtor. All claims must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor. This the successful resolution applicant does on a fresh slate, as has been pointed out by us hereinabove.'

This reasoning applies to claims not filed during the corporate insolvency resolution process too. This bring much needed clarity for resolution applicants who are acquiring distressed assets.

Sub-committees of the CoC

The Supreme Court observed that while the CoC can delegate its administrative powers or power of negotiation with the resolution applicants to a smaller committee, such acts in the ultimate analysis would be required to be approved and ratified by the CoC.

Guarantors liability

The NCLAT decision that the guarantor would be relieved from any payment, once the debt payable by the corporate debtor is cleared in view of the approval of the plan, has been set aside by the Supreme Court, as contrary to Section 31(1) of the IBC, which makes an approved resolution plan binding on *inter alia* the guarantors.

Challenges to the 2019 Amendment Act

330 day timelines: not mandatory

The 2019 Amendment Act introduced a mandatory requirement of completing the corporate insolvency resolution process within 330 days from the insolvency commencement days (inclusive of legal proceedings). However, this provision was introduced in Section 12 and not in Section 31 (relating to approval of the resolution plan by the NCLT) and therefore, a possible interpretation was that 330 day time line is only for submission for CoC- approved plan to the NCLT and not the NCLT to approve the plan. The Supreme Court has struck down the word 'mandatorily' as unconstitutional.

The provision is rather required to be read to state that the corporate insolvency resolution process should 'ordinarily' be completed within 330 days, including the extensions and time taken in legal proceedings and any further extension may be granted only if it can be shown that only a short period is left for completion of the insolvency resolution process beyond 330 days, that it would be in the interest of all stakeholders that the corporate debtor be put back on its feet instead of being sent into liquidation, and that the time taken in legal proceedings is largely due to factors owing to which the fault cannot be ascribed to the litigants before the NCLT and/or NCLAT, the delay or a large part thereof being attributable to the tardy process of the NCLT and/or NCLAT itself.

Before parting, the Supreme Court also clarified that a creditor claiming solely under cheques which were issued on account of ancillary liability of the corporate debtor can not be classified as a financial debt.

Conclusion

The Supreme Court has reinforced the IBC as a primary restructuring tool in India by re-affirming the primacy of the CoC, which is one of the key facets of the IBC, and ensured that pre-bankruptcy entitlements are respected during insolvency process. The clarity on 'fresh slate' that the resolution applicant enjoys will bring relief to many acquirers of assets under the IBC. The Supreme Court has continued the march of the IBC as one of the most modern and progressive restructuring legislations in the world.

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