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ARTICLE

# The Spadework Behind India's Progressive Restructuring Regime: A Contextual Analysis of the IBC (Amendment) Act, 2019

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## Synopsis

The Insolvency and Bankruptcy Code ('IBC') is India's newest legislation relating to the reorganisation and insolvency resolution of corporate persons, partnership firms and individuals while also being solely responsible for reshaping the behaviour of borrowers in the Indian economy. In fact, India has jumped fifty-three (53) places since the commencement of the Code to clinch the seventy-seventh (77) spot in the 'Ease of Doing Business ranking' in 2019. However, the developing nature of this legislation has not prevented the Government from being able to respond promptly to a rapidly evolving economy. For the same reason, the Minister of Finance introduced the Insolvency and Bankruptcy Code (Amendment) Act, 2019 (hereinafter referred to as the 'IBC (Amendment) Act 2019') on 24 July 2019 which accounts for the eighth amendment in relation to the Code, in order to encourage entrepreneurship, ensure availability of credit in the market and balance the interests of stakeholders. It is noteworthy that the most recent amendment principally responds to the position taken by the Adjudicating Authorities under the Code vis-à-vis the *Essar Steel* case. In these circumstances, this article provides a contextual exploratory analysis of six (6) key amendments under the IBC (Amendment) Act 2019 inasmuch as it outlines the former legislation, the pre-existing environment, the need for changes and the potential effect of such changes with respect to each amendment. The analysis of each amendment follows a uniform format: the former legislation, the amendment and its implications.

## Resolution plan vis-à-vis corporate restructuring

### *Former legislation*

Formerly, s.5(26) of the Code defined 'resolution plan' as a plan proposed by the resolution applicant aimed at the rescue of the corporate debtor as a going concern, in accordance with the provisions of the Insolvency and Bankruptcy Code ('Code'). However, the definition did not expressly incorporate complex restructuring schemes such as mergers, amalgamations or acquisitions within its ambit.

Notwithstanding, in December 2018, the NCLAT[1] held that effectuating a scheme of 'amalgamation' presented in the resolution plan complied with the object and purpose of the Code.[2] This was in response to the arguments advanced by appellants that mergers and amalgamation could not be proposed in the resolution plan, on the grounds that it contravened s.30(2) (e) of the Code.[3]

Equally, Regulation 37(1)(c) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Person) Regulations 2016, (hereinafter referred to as 'IBBI (IRP for Corporate Persons) Regulations 2016') also provided an inclusive definition of 'resolution plan' which included mergers, acquisitions and amalgamations within its scope. Nonetheless, related disputes arising out of the Code required a statutory declaration. For this purpose, s.5(26) of the Code was amended.

### *Amendment*

In view of the amendment, the Indian Government has included non-cash corporate restructuring within the definition of a 'resolution plan'[4] in order to enable the market to indulge in dynamic resolution plans leading

Notes

1 National Company Law Appellate Tribunal is the Appellate Authority under the Code; See Section 61 of the Code.
2 *Edelweiss Asset Restructuring Company Ltd. v Synergies Dooray Automotive Limited*, Company Appeal (AT) (Insolvency) No. 169 of 2017, (NCLAT, 14 December 2018).
3 Ibid., at 14.
4 See *Statement of Objects and Reasons*, IBC (Amendment) Bill, 2019 (passed by Lok Sabha, 1 August 2019).

to value maximisation. This means that the resolution plan may include provisions for restructuring of the Corporate Debtor, including mergers, amalgamations and acquisitions.[5]

On this basis, the IBC (Amendment) Act 2019 seeks to grant statutory recognition to the existing delegated legislation, i.e. Regulation 37(1)(c) of the IBBI (IRP for Corporate Persons) Regulations 2016. Importantly, the amendment recognises and approves the various restructuring plans for the resolution of an insolvent entity, which could help the Corporate Debtor in augmenting the value of its stressed assets. For this purpose, the Committee of Creditors ('CoC') must accurately identify if the Corporate Debtor undergoing Corporate Insolvency Resolution Process ('CIRP') is viable and must rescue a 'failing, viable Corporate Debtor while close a failing, unviable one.'[6]

In order to effectively understand the scope of this amendment, vital implications under the Code are outlined below.

### *Implication*

- Reorganisation proposals involving mergers, amalgamations and acquisitions cannot be henceforth rejected for failing to meet the criteria provided under s.5(26) of the Code. This will help in maximising the value of stressed assets, which is in line with the objectives of the Code.
- The amendments put no restrictions on the form and manner of a resolution plan. A plan could involve the purchase of the equity or assets of the corporate debtor, any infusion of additional debt, the de-merger of the debtor's businesses, financial 'haircuts' taken by the creditors, or the extinguishment of liabilities.[7]
- Under the previous framework, restructuring schemes could only be proposed during liquidation via s.230-232 of the Companies Act 2013. Unfortunately, this was used by promoters of the defaulting Corporate Debtor to circumvent s.29A of the Code that dealt with 'related parties'. In effect, the promoters of the defaulting Corporate Debtor could submit restructuring schemes under the Companies Act 2013 after the CoC had rejected the resolution plan and ordered its liquidation. Therefore, in order to protect the Corporate Debtor from its own management, the Supreme Court has recently held that an application under s. 230 of the Companies Act, 2013 is not maintainable if it is made by a person otherwise ineligible under s. 29A of the Code.[8] Nevertheless, pursuant to the amendment, restructuring schemes can now be incorporated in the resolution plan and tabled before the CoC itself. In fact, the NCLAT has acknowledged the overlap between the Companies Act 2013 and the Code in *Edelweiss Asset Reconstruction Co. Ltd. v Synergies Dooray Automotive Limited*[9] and held that once a resolution plan is approved, a formal order of amalgamation under s.230-232 of the Companies Act 2013 may be required and not prior to that.

## Judicial mandate for ascertaining the existence of default

The Code allows Financial Creditors,[10] Operational Creditors[11] as well as Corporate Debtors to initiate the CIRP. The Adjudicating Authority and the Appellate Authority prescribed under the Code, i.e. NCLT[12]& NCLAT,[13] either accepts or rejects the application on the basis of the grounds mentioned therein. Recently, controversies have arisen regarding the non-adherence to time-lines by the Adjudicating Authority as prescribed under the Code. This has been addressed in the amending Act.

### *Former legislation*

Formerly, s.7(4) of the Code stipulated that the Adjudicating Authority shall ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the Financial Creditor within fourteen (14) days of receipt of the application to initiate CIRP. Pursuant to this, the Adjudicating Authority either accepted or rejected the said application.

*Notes*

5 Section 5(26), Insolvency and Bankruptcy Code, 2016.
6 *Standard Chartered Bank v Satish Ku.Gupta, R.P of Essar Steel & Ors.*, Company Appeal (AT)(Insolvency) No. 242 of 2019 (NCLAT, 4 July 2019).
7 ICSI, 'Corporate Restructuring, Insolvency, Liquidation and Winding up' <www.icsi.edu/media/webmodules/Corporate_Restructuring_Insolvency_LiquidationandWindingUp.pdf>, 7 Sept. 2019.
8 *Jindal Steel and Power Limited v Arun Kumar Jagatramka*, Civil Appeal (AT) No. 221 of 2018 (NCLAT, 24 October 2019).
9 *Edelweiss Asset Restructuring Company Ltd. v Synergies Dooray Automotive Limited*, Company Appeal (AT) (Insolvency) No. 169 of 2017, (NCLAT, 14 December 2018), p. 37.
10 'Financial creditor' means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to; see Section 5(7) of the Code.
11 'Operational creditor' means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred; see Section 5(20) of the Code.
12 National Company Law Tribunal is the Adjudicating Authority under the Code; see Section 5(1) of the Code.
13 *Supra* n. 1.


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Precedential law stated that if the Financial Creditor satisfied the requirements under s.7 of the Code, the Adjudicating Authority had no discretion to reject the application or defer it unless the Corporate Debtor submitted to settle the claim.[14] In fact, the Supreme Court in *Innoventive Industries Ltd.v. ICICI Banks*[15] ruled that the 'adjudicating authority' was required to ascertain the existence of default[16] within fourteen (14) days. For this purpose, the Apex Court, i.e. the Supreme Court, further declared that it was immaterial whether the financial debt was disputed or not, as long as it was due under s.7 of the Code.[17] However, the fourteen (14) day time-period allotted to the Adjudicating Authority for ascertaining the existence of default and accepting or rejecting the CIRP application was only directory and not mandatory.[18] In fact, this principle was extended to other statutory time-lines under s.7(5), s.9(5) and s.10(4) of the Code. This was proving to be a nightmare for stakeholders who were hoping for a speedy resolution.

### *Amendment*

In the circumstances, the amendment strives to rule out any arbitrary extensions of time during the CIRP. For this purpose, the amendment asserts that if the Adjudicating Authority does not ascertain the existence of default or pass an order for approval or rejection of the CIRP application within the prescribed time, it shall record its reasons in writing.[19]

It is safe to assume that the amendment is directed at the decision in *Surendra Trading Co. v Juggilal Kamalapat*[20] which held that the fourteen (14) day time-period assigned to the Adjudicating Authority for ascertaining the existence of default, as well as admitting or rejecting an application under s.7, is not to be read as mandatory. On this premise, the most recent amendment seeks to convey that despite being directory in nature, the Adjudicating Authority must record its reasons in writing in the event of any delay.

Equally, the judicial position clarifies that the Adjudicating Authority must provide a right of hearing to the Corporate Debtor, in accordance with the principles of natural justice,[21] at the time of admitting an application to initiate the CIRP. Thus the Adjudicating Authority must hear both parties in order to ascertain the existence of a default, along with the records furnished from the informational utility. However, if it fails to admit or reject an application after ascertaining the existence of a default within fourteen (14) days, it must provide for the same in writing. Nevertheless, the extent to which the amendment may impact the CIRP timeline can only be determined by the Courts.

### *Implications*

- The amendment enforces judicial discipline inasmuch as the Adjudicating Authority cannot belatedly pass a non-reasoned order for admission or rejection of an application under s.7 of the Code. Additionally, if there is any delay in determination of the default exceeding fourteen (14) days, such delay must be accounted for in writing.
- It reiterates the position that the Adjudicating Authority has limited discretion to admit or reject an application to initiate the CIRP if the Financial Creditor satisfies all the requirements provided under s.7 of the Code. In fact, if such discretion is exercised arbitrarily, the reasons provided must be sufficient.

## 'Time is money' – Benjamin Franklin

The Minister of Finance, Ms. Nirmala Sitharaman tabled the IBC (Amendment) Bill 2019 before the Rajya Sabha[22] on 24 July 2019 in order to, *inter alia*, limit the CIRP as a time-bound process. The most recent amendment stipulates an extended time-period of three hundred and thirty (330) days for completion of the CIRP. In order to understand the need for such a move, it is pertinent to review the former legislation from the Code.

### *Former legislation*

Formerly, s.12(3) of the Code prescribed that the Adjudicating Authority could extend the CIRP beyond one hundred and eighty (180) days if it deemed fit, but only by a period not exceeding ninety (90) days. In other words, the maximum time allotted for the insolvency resolution process under the Code was two hundred and

*Notes*

14 *Nakul Bharana v ICICI Bank Limited*, Company Appeal (AT) (Insolvency) No. 701 of 2019 (NCLAT, 10 July 2019) p. 5.
15 *Innoventive Industries Ltd. v ICICI Bank*, (2018) 1 SCC 407.
16 Ibid., at 438.
17 Ibid., at 439.
18 *Surendra Trading Company v Juggilal Kamlapat Jute Mills Co. Limited*, (2017) 16 SCC 143.
19 Section 7(4), Insolvency and Bankruptcy Code, 2016.
20 *Surendra Trading Company v Juggilal Kamlapat Jute Mills Co. Limited*, (2017) 16 SCC 143.
21 *Swiss Ribbons Pvt. Ltd. v Union of India*, (2019) 4 SCC 17.
22 The Rajya Sabha or the Council of States is the upper house of the bicameral Parliament of India; see Article 79 of the Constitution of India.




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seventy (270) days, failing which the Corporate Debtor had to undergo liquidation under s.33 of the Code.

It is well-known that delays can affect the insolvency resolution process so as to make reorganisation unfeasible, induce liquidation and cause value destruction.[23] For this reason, circumscribing the insolvency resolution process by a strict timeline is essential. In fact, the Preamble to the Code reiterates this stance while describing the Code as 'an Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner'.[24]

It is pertinent to mention that the Supreme Court had conferred on the Adjudicating Authority the discretionary power to admit or reject an application to initiate the CIRP within the fourteen (14) day time-period.[25] The Apex Court relied on the settled principle of law that 'where a statutory functionary is asked to perform a statutory duty within the time prescribed therefor [sic], the same would be directory and not mandatory'.[26] Consequently, this caused delay and uncertainty in the insolvency process. Separately, the timelines for obtaining the necessary approvals from the State and Central Government, which are required to be provided in the resolution plan,[27] were not specified.

While matters stood thus, on 4 October 2018 the Apex Court held that the prescribed timeline for the completion of the CIRP is strictly mandatory in nature.[28] The Honourable Court further held that the timeline provided under Regulation 40A of the IBBI (IRP for Corporate Persons) Regulations 2016 must be followed 'as closely as possible'.[29] Therefore, prior to the amending act, the position of the judicial authorities was clear: a) the fourteen (14) day timeline for admission/rejection of the insolvency application was directory and not mandatory; b) the two hundred and seventy (270) day timeline for the entire corporate insolvency resolution process was mandatory with uncertainty regarding the inclusion of time taken for legal proceedings or other unforeseen circumstances.

However, the position still remained unclear as to whether or not the two hundred and seventy (270) day timeline included the time taken in litigation proceedings. One view asserted that the Adjudicating Authority or Appellate Tribunal was open to exclude certain periods for the purpose of counting the total period of two hundred and seventy (270) days if the facts and circumstances justified exclusion in unforeseen circumstances. This included, *inter-alia*, the time taken during the operation of stay orders.[30] Separately, the Supreme Court held that 'a reasonable and balanced construction of this statute would therefore lead to the result that, where a resolution plan is upheld by the Appellate Authority, either by way of allowing or dismissing an appeal before it, the period of time taken in litigation ought to be excluded'.[31] In essence, ambiguity pertaining to the inclusion of legal proceedings within the prescribed timeline, together with a large number of pending cases eclipsing the timeline, led to the present amendment.

### *Amendment*

In order to clarify the position regarding the exclusion of the time taken for litigation proceedings during the CIRP from the external time limit, the amendment declares that the CIRP must be mandatorily completed within three hundred and thirty (330) days. Pertinently, this period includes any extension granted under s.12 as well as any time taken for legal proceedings in relation to such insolvency resolution processes.[32]

It is noteworthy that by February 2019, within twenty seven (27) months of commencement of the Code, as many as fourteen thousand (14,000) applications had been filed for initiation of CIRPs. In fact, as of 31 March 2019, the NCLT has ordered the commencement of CIRP for 1858 Corporate Debtors.[33] Thus, strict compliance with the statutory timeline has become a priority given the limited number of NCLT and NCLAT judges and the multitude of companies with stressed assets. However, the renewed timeline will have varied implications on the insolvency resolution process.

**Notes**

23 Insolvency and Bankruptcy Board of India, 'Understanding the Insolvency and Bankruptcy Code, 2016 – Analysing developments in Jurisprudence', p. 16,<www.ibbi.gov.in/webadmin/pdf/whatsnew/2019/Jun/190609_UnderstandingtheIBC_Final_2019-06-09%2018:20:22.pdf>, 6 July 2019.

24 See Preamble, The Insolvency and Bankruptcy Code, 2016.

25 *Surendra Trading Company v Juggilal Kamlapat Jute Mills Co. Limited*, (2017) 16 SCC 143.

26 *Surendra Trading Company v Juggilal Kamlapat Jute Mills Co. Limited*, (2017) 16 SCC 143, p. 18.

27 Regulation 37(l),IBBI(IRP for Corporate Persons) Regulations, 2016.

28 *ArcelorMittal India Pvt. Ltd. v Satish Kumar Gupta & Ors.*,(2019) 2 SCC 1.

29 Ibid., p. 77.

30 *Quinn Logistics v Mack Soft Tech.*, Company Appeal (AT) (Insolvency) No. 185 of 2018, pp. 10 (NCLAT, 8 May 2018).

31 *ArcelorMittal India Pvt. Ltd. v Satish Kumar Gupta & Ors.*,(2019) 2 SCC 1, p. 86.

32 Section 12, Insolvency and Bankruptcy Code, 2016.

33 Ministry of Finance, Government of India, 'Monetary Management and Financial Intermediation', in *Economic Survey* 2018-2019, Volume II, p. 78.<www.indiabudget.gov.in/economicsurvey/doc/vol2chapter/echap03_vol2.pdf>, July 2019.


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### *Implications*

- The amendment will prevent inordinate delays in the completion of the CIRP and avoid value deterioration of the concerned assets. This will go a long way to debunking the misconception that the IBC proceedings are a defaulter's paradise.
- The external time limit of three hundred and thirty (330) days, has been confirmed as mandatory which cannot be extended thenceforth. In fact, the time taken for litigation proceedings will be also be included within this limit.
- The amendment specifically includes litigation proceedings within the three hundred and thirty (330) day time-limit for the CIRP. This creates an ambiguity regarding the inclusion of time-periods, other than that of the litigation proceedings, within the time limit. For instance, the delay in the commencement of the CIRP due to the inability of the Resolution Professional to access the company premises on account of Naxalite tensions has been held to be excluded for the purposes of calculating the maximum time taken for the CIRP.[34] However, such an intervening period finds no place in the most recent amendment for inclusion within the three hundred and thirty (330) day limit.
- Serving as a clarifying clause, this amendment will apply retrospectively. Corporate Debtors who have exhausted the two hundred and seventy (270) day time-limit without completion of the CIRP can finish it within ninety (90) days from the date of commencement of the IBC (Amendment) Act 2019.

## Voting capacity of an authorised representative

Pursuant to the Insolvency Law Committee report, the Insolvency and Bankruptcy Code (Second Amendment) Act 2018 was passed by the Parliament on 17 August 2018 which recognised allottees or homebuyers under a real estate project as financial creditors. The present amendment strives to facilitate the same by laying down a simple procedure for home buyers to participate in the CoC voting process effectively.

### *Former legislation*

Formerly, s.25A(3) of the Code stipulated that an authorised representative for several financial creditors under s.21(6A) had to cast his vote in respect of each financial creditor in accordance with instructions received from each financial creditor, to the extent of his voting share. In other words, creditors holding securities, deposits or an entire class of creditors could appoint an authorised representative to participate and vote on their behalf in the meetings of CoC. The authorised representative had to vote for each creditor individually to the extent of his or her voting share. The process became a cumbersome and tedious exercise considering the large number of creditors involved in certain instances. For the same reason, the decision in *Chitra Sharma v Union of India*[35] led to complications, where a majority of the CoC comprised of homebuyers.

On 13 July 2018, the Insolvency and Bankruptcy Board of India ('IBBI') partly addressed this concern by issuing a circular for facilitating the appointment of an authorised representative for a class of creditors under s.21(6A)(b) of the Code.[36] Accordingly, where the corporate debtor had at least ten financial creditors in a class, the interim Resolution Professional was to offer a choice of three insolvency professionals to the creditors to act as their authorised representative. The authorised representative had to collect voting instructions from the respective class of creditors, attend the meetings of the committee of creditors and cast votes in respect of the said class in accordance with the instructions received from the creditors. Nevertheless, the voting procedure laid down by the Courts for authorised representatives prior to the amendment was proving to be impractical and time consuming.

### *Amendment*

In response, the amendment ensures that the authorised representative under s.21(6A) votes on behalf of all the creditors he represents based on a majority. In other words, instead of voting for each financial creditor according to his voting share, the amendment establishes that the authorised representative can vote singularly on behalf of all the financial creditors he represents based on the instructions of more than 50% by majority.[37] However, it has been clarified that the voting procedure for withdrawal of an application to initiate the CIRP under s.12A of the Code would not attract the most recent amendment but instead be governed by sub-clause (3),

**Notes**

34 *Ajay Agarwal v Shantanu T. Ray, RP of AML Steel and Power,* Company Appeal(AT) (Insolvency) No. 61 of 2019, pp. 3 (NCLAT, 18 January 2019).

35 *Chitra Sharma v Union of India*,(2018) 18 SCC 575.

36 *Appointment of Authorised Representative for Classes of Creditors under section 21 (6A) (b) of the Insolvency and Bankruptcy Code, 2016,* IBBICircular No. IBBI/CIRP/015/2018 (13 July 2018),<ibbi.gov.in//webadmin/pdf/legalframwork/2018/Jul/ClarificationNo.%20IBBI-CIRP-015-2018%20dated%2013072018-Approved_2018-07-13%2020:07:34.pdf>, 8 September 2019.

37 Section 25A(3A), Insolvency and Bankruptcy Code, 2016.


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as was operating earlier.[38] Accordingly, for the purposes of withdrawing an application to initiate the CIRP under s.12A of the Code, the authorised representative must cast his or her vote in respect of each financial creditor to the extent of that creditors voting share, instead of voting collectively.

It is noteworthy that since the commencement of the IBC (Amendment) Act 2019, the Supreme Court has already declared that s.25A(3A) irons out the creases with respect to the voting rights of authorised representatives. In addition to this, the Supreme Court upheld the constitutional validity of homebuyers as financial creditors in the judgment delivered by Justice R.F. Nariman.[39] The amendment boasts significant practical relevance and understanding its precise impact is essential.

### *Implications*

- The amendment simplifies the voting procedure undertaken by authorised representatives in CoC meetings in cases comprising of a large group of diverse financial creditors. In addition, the amended procedure will be more efficient with regards to time consumption and also facilitate decision making within the CoC, thus falling in line with the objectives of the Code.
- In cases of withdrawal of the CIRP application under s.12A, the authorised representative will not vote on behalf of the financial creditors collectively but individually, according to their voting rights. It may be argued that this special exemption has been made on account of the high approval threshold required under s.12A, thus catering to situations where the entire CoC is comprised of financial creditors under s.21A(6A) of the Code. In such circumstances, merely 50% or more votes in majority could enable the CoC to withdraw the insolvency application instead of the required 90% voting approval. Thus, special provision has been made to exempt s.12A from the new amendment.

## In response to the *Essar Steel* case: rights of OC's, dissenting and unsecured FC's

The contentious case of *Essar Steel* order dated 4 July 2019 significantly affected the credit hierarchy amongst operational creditors and financial creditors including unsecured financial creditors. In the dispute, ArcelorMittal bid for the sale of ailing *Essar Steel* for an amount of Rs. 42,000 Cr.[40] While matters stood thus, the NCLAT made a ruling that uprooted the fundamental tenets of the Code. First, it ruled that both financial and operational creditors were to be treated similarly for the purposes of distribution under the resolution plan. Second, it did not draw any distinction between secured and unsecured financial creditors for the purposes of preparation of the resolution plan and third, it held that the order of priority under s.53 was only applicable to liquidation proceedings. The finance minister, Ms. Nirmala Sitharaman revealed that the NCLAT ruling wholly defeated the spirit and purpose of the Code.[41] It was only a matter of time before the legislature rectified the stance regarding the rights of creditors under the Code.

### *Former Legislation*

Formerly, s.30 of the Code provided a framework for submission of the resolution plan. *Inter-alia*, it prescribed factors which were to be considered by the Resolution Professional for the purpose of examining the resolution plan prior to presenting it for approval before the Committee of Creditors. It further specified the voting share required by the Committee of Creditors for approval of the resolution plan.

Specifically, s.30(2)(b) required the Resolution Professional to ascertain that each resolution plan provided for the payment of the operational creditor's debt in the manner specified by the Board; this could not be less than the amount formulated for payment to the operational creditors in the event of liquidation of the corporate debtor under s.53. In essence, prior to the amendment, the Resolution Professional had to merely ensure that the resolution plan provided for a minimum payment of liquidation value ascribable to operational creditors. At this point it is important to understand that the statutory requirements prescribed under s.30(2) are binding on the Resolution Professional. However, the

**Notes**

38 Ibid.

39 *Pioneer Urban Land and Infrastructure Limited and Anr. v Union of India and Ors.*, Civil Appeal No. 12238 of 2018 and Civil Appeal No. 1677 of 2019, p. 55 (Supreme Court, 2 April 2019).

40 Ashish Aryan, 'Will Challenge IBC amendments: Essar Steel operational creditors tell SC' <www.business-standard.com/article/companies/will-challenge-ibc-amendments-essar-steel-operational-creditors-tells-sc-119080701614_1.html>, 8 August 2019.

41 Asit Ranjan Mishra, 'Govt. shows steely intent in resolving thorny IBC issues', <www.livemint.com/news/india/govt-shows-steely-intent-in-resolving-thorny-ibc-issues-1564425696756.html>, 30 July 2019.


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requisites therein are only for testing the validity of the approved decision of the CoC and not for reversing a resolution plan that has been rejected in exercise of its business decision.[42]

Furthermore, formerly s.30(4) stated that the CoC could approve the resolution plan after considering its feasibility and viability, by a voting share of not less than 66%. Importantly, the order of priority under s.53 of the Code pertaining to distribution of assets during liquidation was not applicable to the resolution plan.[43] In fact, it was merely relied upon by the CoC to compute the liquidation value attributable to the Operational Creditors[44] and for no other purpose.

Separately, Regulation 38(1)(c) of the IBBI (IRP for Corporate Persons) Regulations 2016 had earlier conferred on the dissenting financial creditors the right to a minimum payment of not less than the liquidation value of their debt. However, in *Central Bank of India v RP of Sirpur Paper Mills Ltd.*,[45] the NCLAT observed that Regulation 38(1)(c) was inconsistent with the objectives of the I&B Code. It further opined that the IBBI could not mandate that payments to operational creditors or dissenting financial creditors had to be prioritised over other financial creditors without employing discrimination.[46] Consequently, Regulation 38(1)(c) was amended.[47]

Understandably, the CoC exercises indubitable commercial wisdom while determining an appropriate resolution plan. As a matter of fact, even the IBBI cannot directly or indirectly regulate the manner in which commercial wisdom is exercised by financial creditors during voting of the resolution plan[48] under s.196 of the Code. In fact, the Apex Court has repeatedly held that the Adjudicating Authority has no jurisdiction to evaluate the commercial decision of CoC, much less to inquire into the fairness of any rejection of the resolution plan by dissenting financial creditors.[49]

Regarding the position *inter se* of secured and unsecured financial creditors, the judicial pronouncement in the impugned *Essar Steel* order is notable. The relevant paragraph from the aforesaid order has been extracted below:-

'If both s.5(7) and s.5(8) are read together, it is evident that there is no distinction made between one 'Financial Creditor' or another. All persons to whom a financial debt is owed by the 'Corporate Debtor', which debt is disbursed against the consideration for time value of money, whether they come within one or other clause of s.5(8), all of such person form one class i.e. 'Financial Creditor'. They cannot be sub-classified as 'Secured' or 'Unsecured Financial Creditor' for the purpose of preparation of the 'Resolution Plan' by the 'Resolution Applicant.'[50]

Condensing the above, the former provisions of the Code low-balled the payments due to operational creditors by merely guaranteeing them the liquidation value of their debt. For dissenting financial creditors, the situation was worse as they were not even entitled to any minimum amount. In addition to this, the *Essar Steel* case distorted the credit hierarchy between secured and unsecured financial creditors and operational creditors upon distribution. To take prompt action against these changes, the Cabinet made substantial amendments to s.30(2)(b) and s.30(4)(b) of the Code.

### *Amendment*

#### a) Payment of debts due to Operational Creditors: Subject to a higher threshold

The amended s.30(2)(b) clause prescribes that for payments to be made to operational creditors in the resolution plan, the higher of the amount of liquidation value under s.53 and the amount which would be due if the distribution complied with the order of priority as provided under s.53(1), shall be provided in the plan.

This manifests a more favourable disposition towards the operational creditors under the Code by providing an opportunity for them to realise an amount greater than the prescribed payment on liquidation. This has been a

**Notes**

42 *K. Sashidhar v Indian Overseas Bank*, Civil Appeal No. 10763 of 2018, Civil Appeal No. 10719 of 2018 and SLP (C) No. 29181 of 2018, pp. 37 (Supreme Court, 5 February 2019).

43 *Standard Chartered Bank v Satish Ku.Gupta, R.P of Essar Steel & Ors.*, Company Appeal (AT)(Insolvency) No. 242 of 2019 (NCLAT, 4 July 2019), p. 87.

44 *Supra* n. 23, at 45; see also S. Bansal & Corporate Law Services Group, 'Guide to Liquidation Valuation for Insolvency Resolution under the Insolvency Code', p. 5 <vinodkothari.com/wp-content/uploads/2017/02/Guide_to_Liquidation_Valuation_for_Insolvency_Resolution_under_the_Code.pdf>, 30 December 2016.

45 *Central Bank of India v RP of Sirpur Paper Mills Ltd.*, Company Appeal (AT) (Insolvency) No. 526 of 2018, p. 9 (NCLAT, 12 September 2018).

46 Ibid., at 4.

47 See Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Fourth Amendment) Regulations, 2018, IBBI Notification No. IBBI/2018-19/GN/REG032, <ibbi.gov.in/webadmin/pdf/whatsnew/2018/Oct/CIRP%20Amendment-5.10.2018_2018-10-05%2023:21:24.pdf>, 5 October 2018.

48 *K. Sashidhar v Indian Overseas Bank*, Civil Appeal No. 10763 of 2018, Civil Appeal No. 10719 of 2018 and SLP (C) No. 29181 of 2018, pp. 37 (Supreme Court, 5 February 2019), p. 80.

49 Ibid., p. 60.

50 *Standard Chartered Bank v Satish Ku.Gupta, R.P of Essar Steel & Ors.*, Company Appeal (AT)(Insolvency) No. 242 of 2019 (NCLAT, 4 July 2019), p. 79.


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contentious issue since the commencement of the Code. Recently, the constitutionality of s.53 of the Code was challenged on the grounds of being discriminatory towards operational creditors.[51] It was contended that the order of priority established under s.53 favoured the financial creditors over operational creditors. The Apex Court drew qualitative differences between both categories of creditor, in terms of restructuring expertise, objective of lending, (i.e. return on investment) and the effect on the economy. They held that a legitimate interest was being protected by s.53 of the Code in favour of financial creditors.[52] Therefore, it could be said that the new amendment to s.30(2)(b) has been introduced in Parliament in order to quell discontent amongst the Operational creditors. In addition to this, existing Regulation Reg.38 of the IBBI (IRP for Corporate Persons) Regulations further strengthens the rights of operational creditors by statutorily incorporating the principle of fair and equitable dealing, together with providing for priority in payment over financial creditors.

Lastly, the Supreme Court has observed that, 'the NCLAT, while looking into viability and feasibility of resolution plans that are approved by the Committee of Creditors, has always gone into whether operational creditors are given roughly the same treatment as financial creditors, and if they are not, such plans are either rejected or modified so that the operational creditors' rights are safeguarded'.[53] For the same reason, financial creditors are required to bear in mind that the legislative intent of the Code is to bring about a resolution and revival of the corporate debtor, so as to not only benefit the corporate debtor but also other stakeholders in equal measure.[54]

### b) Restoration of Payment of Liquidation Value of debt to Dissenting Financial Creditors

Equally, s.30(2)(b) provides for dissenting financial creditors who vote against the resolution plan insomuch as they are required to receive an amount that is not less than the liquidation value of their debt on distribution. This safeguards dissenting creditors' rights against any biased decisions by the CoC based on majority rule.

In this respect, the NCLAT has previously held that the resolution plan cannot discriminate between those who are similarly situated.[55] Needless to say, the rights guaranteed to dissenting financial creditors has been an ongoing issue. The amendment clarifies this position by restoring the need for a minimum payment to the dissenting financial creditors on the basis of the liquidation value of their debts. The rights of dissenting financial creditors have also been recognised by the Insolvency Law Committee, by acknowledging that 'dissenting financial creditors are placed in a disadvantageous position vis-à-vis the operational creditors, as the latter are given priority in payment not only ahead of other financial creditors but also in terms of time, i.e. within thirty (30) days of the approval of the plan. Thus the right to be paid prior to the assenting financial creditors may not be diluted'.[56]

In addition to this, an explanation has been inserted within the IBC (Amendment) Act 2019 stating that the distribution in accordance with the provisions of s.30(2)(b) shall be fair and equitable to the creditors. The amendment further provides that the said clause will operate retrospectively to situations where the resolution plan has not been approved or rejected, where an appeal has been preferred under s.61 or s.62 which is not time-barred and where a legal proceeding has been initiated against the decision of the adjudicating authority with respect to a resolution plan.

### c) Waterfall arrangement

Another significant change to the pre-existing status quo was amending the CoC's criterion for approval of a resolution plan under s.30(4)(b). Consequently, the CoC will have to give due consideration to the feasibility, viability and the manner of distribution proposed in the resolution plan, which may take into account the order of priority amongst creditors as laid down in s.53(1). In addition to this, the priority and value of the security interest of secured creditors may also be considered by the CoC while approving the resolution plan.

The amendment extends the scope of s.53(1) of the Code to not only liquidation proceedings but also as a criterion for the approval of resolution plans. The priority and value of the security interests of the secured creditor has to be equally factored in for consideration before the CoC approves the resolution plan. However, whether the term 'may' in the amended s.30(4)(b) of the Code is to be interpreted as 'shall', remains a question to be appropriately answered by the Courts.

Importantly, the amendment acts as a feedback to the NCLAT Order dated 4 July 2019, also known as the

Notes

51 *Swiss Ribbons Pvt. Ltd. v Union of India*, (2019) 4 SCC 17.
52 Ibid., at 68, 69.
53 Ibid., at 84.
54 *K. Sashidhar v Indian Overseas Bank*, Civil Appeal No. 10763 of 2018, Civil Appeal No. 10719 of 2018 and SLP (C) No. 29181 of 2018, p. 37 (Supreme Court, 5 February 2019), p. 79.
55 *Central Bank of India v RP of Sirpur Paper Mills Ltd.*, Company Appeal (AT) (Insolvency) No. 526 of 2018, p. 9 (NCLAT, 12 September 2018), p. 22.
56 Insolvency Law Committee, *Report of the Insolvency Law Committee*, <www.mca.gov.in/Ministry/pdf/ReportInsolvencyLawCommittee_12042019.pdf>, pp. 30.2.


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impugned *Essar Steel* order. By virtue of this order, the Honourable Tribunal equated the rights of operational creditors in distribution proceedings with those of financial creditors.[57] Additionally, the NCLAT safeguarded the rights of other unsecured financial creditors by disallowing any further classification of financial creditors.[58] It also held that the profits from proceeds were to be distributed between both financial creditors and operational creditors on a *pro-rata* basis.[59] On this premise, both financial creditors and operational creditors were directed to receive 60.7% of their total claim. As a result, the financial creditors appealed to the Honourable Supreme Court in pursuance of the protest against lapse in credit hierarchy. The Apex Court has recently allowed the appeals filed by the CoC and set aside a lion's share of the impugned NCLAT Order in the landmark *Essar Steel* case.[60] The three judge bench of the Supreme Court has relied *inter alia* on the IBC (Amendment) Act, 2019 to restore the credit hierarchy between operational and financial creditors while concurrently recognising the principle of differential payments to different classes of creditors. In effect, the Bench clarified that equitable treatment is to be accorded to similarly situated creditors and therefore the operational creditors could not have been treated at par with the financial creditors.

Nevertheless, the most recent amendment re-establishes credit hierarchy amongst creditors and restores investor confidence in the credit markets. This is based on the fact that payments to financial and operational creditors during distribution would now be guided by s.53 of the Code, leading to more favourable treatment towards financial creditors. In the circumstances, it may be assumed that the distinction drawn between financial and operational creditors in *Swiss Ribbons v Union of India*[61] played a significant role in furtherance of the amendment. Notwithstanding, Kapil Sibal in his Rajya Sabha speech on the IBC (Amendment) Bill 2019 has denounced the Legislature for having tried to resolve the impugned *Essar Steel* Order, i.e. a judicial dispute, by legislation. The said matter was *sub judice* in the Supreme Court when the amendment was promulgated. Interestingly, nationalised banks were involved in the dispute holding vested interests in the matter.[62]

The amendment to s.30(4)(b) also removes ambiguity regarding differences in the treatment of secured and unsecured financial creditors. In fact, it adds a qualification tool for distribution amongst financial creditors by the introduction of 'value' and 'priority' of the security interest of a secured creditor in the legislation. Accordingly, the CoC must consider the priority of charge and the value of the secured interests of secured financial creditors in order to approve the resolution plan. Suffice to say, the amendment retaliates against the impugned *Essar Steel* order by clarifying that operational and unsecured financial creditors should not be treated on a par with secured financial creditors and that the decision should be based on the priority and value of the security interests.

In order to understand the significance of unsecured financial creditors as well as the overarching intention of the Code to prioritise debts owed to them, attention must be drawn to the Preamble to the Code. In this regard, the Report of the BLRC Volume 1 (2015) ('BLRC Report') states as follows:

> 'The Committee has recommended to keep the right of the Central and State Government in the distribution waterfall in liquidation at a priority below the unsecured financial creditors in addition to all kinds of secured creditors for promoting the availability of credit and developing a market for unsecured financing (including the development of bond markets). In the long run, this would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth. The government will also be the beneficiary of this process as economic growth will increase revenues. Further, efficiency enhancement, and consequent greater value capture through the proposed insolvency regime, will bring additional gains to both the economy and the exchequer.'[63]

Further, in the context of inter-creditor agreements under the liquidation waterfall, the Insolvency Law Committee has already supported the supremacy of inter-creditor agreements vis-à-vis s.53 of the Code.[64] This means that inter-creditor agreements, or sub-ordination agreements, shall be respected despite the liquidation waterfall under the Code. However, in spite of prompt action taken by the Government, the amendment has been subject to criticism. In order to analyse the true effect of the amendment, attention must be drawn to its

**Notes**

57 *Standard Chartered Bank v Satish Ku.Gupta, R.P of Essar Steel & Ors.*, Company Appeal (AT)(Insolvency) No. 242 of 2019 (NCLAT, 4 July 2019).
58 Ibid.
59 Ibid.
60 *Committee of Creditors of Essar Steel India Limited Through Authorized Signatory v Satish Kumar Gupta & Ors.*, Civil Appeal No.8766-67 of 2019, (Supreme Court, 15 November 2019).
61 *Swiss Ribbons Pvt. Ltd. v Union of India*, (2019) 4 SCC 17.
62 Speech by Sh. Kapil Sibal, *The Constitution (124th Amendment) Bill, 2019*, Rajya Sabha, (9 January 2019).
63 Bankruptcy Law Reforms Committee, Lok Sabha, *The Report of the Bankruptcy Law Reforms Committee Vol I, Rationale and Design*, November 2015, p. 14.
64 Ministry of Corporate Affairs, Government of India, *Report of the Insolvency Law Committee*, p. 21.5, <http://www.mca.gov.in/Ministry/pdf/ReportInsolvencyLawCommittee_12042019.pdf>, 9 August 2019.




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impact on the rights of creditors, discrimination inter se creditors and judicial review of the resolution plan.

### *Implications*

- The amendment pins down on the payments due against operational creditors by limiting s.30(2)(b) of the Code. This provides much needed clarity regarding the treatment of operational creditors vis-à-vis financial creditors.
- The rights of the dissenting financial creditors vis-à-vis the majority are now fortified by the *de minimus* statutory payment prescribed under the amendment.
- The qualifications exercised by the words 'fair' and 'equitable' may subject the resolution plan to superfluous judicial review. Therefore, the onus will lie on the Courts to define these terms for clarity.
- Contentiously, the amendment has resolved a judicial dispute arising out of the *Essar Steel* NCLAT Order by legislation. In pursuance of this, the amendment revokes the principle of treating secured financial, operational and unsecured financial creditors at par vis-à-vis the distribution process.
- The order of priority incorporated in the liquidation waterfall under s.53 of the Code will now act as a criterion for approval of resolution plans submitted by potential bidders.

## Binding capacity of resolution plans vis-à-vis statutory authorities

The prior legal position did not explicitly bind the resolution plan on the statutory authorities. This led to statutory authorities commencing large scale litigations against successful resolution applicants for recovering their dues beyond the scope of the Code. In this light, the following analysis evaluates the precedential law and demonstrates the need for the recent amendment.

### *Former legislation*

Formerly, s.31 of the Code ensured that the resolution plan met the requirements prescribed under s.30(2) of the Code subject to the satisfaction of the Adjudicating Authority. Accordingly, the Adjudicating Authority either approved or rejected the resolution plan based on compliance with the statutory requirements outlined under s.30(2) of the Code. It is noteworthy that on approval, the resolution plan bound the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. However, it did not explicitly bind the Government or local authority under this provision.

Consequently, tax authorities and other government regulators were in disarray regarding the binding power of an approved resolution plan on statutory authorities. For the purposes of this discussion, two premises must be considered in order to understand the judicial position prior to the amendment: (i) whether statutory dues constituted a part of 'operational debt', and (ii) whether an approved resolution plan bound the statutory authorities.

#### a) Inclusion of statutory dues under 'operational debt'

This came up for consideration in *Pr. DG of Income Tax v Synergies Dooray Automotive Ltd. & Ors.*, where the NCLAT unequivocally held that statutory liabilities like 'Income Tax' or 'Value added Tax' arose only when the Corporate Debtor was operational, and that such dues had a direct nexus with the operations of the Corporate Debtor. On this basis, the Appellate Authority held that the statutory dues came within the meaning of 'operational debt'.[65] In effect, it concluded that all the stakeholders, including the financial creditors as well as statutory authorities acting as operational creditors, had to comply with the approved resolution plan. Equally, in *RMS Employees Welfare Trust v Anil Goyal*,[66] the NCLAT reiterated the position taken in the *Swiss Ribbons*[67] case regarding statutory dues and held that a waiver of income tax from the resolution plan was without jurisdiction as it came within the ambit of an 'operational debt' and thus could not be less than the amount to be paid to the operational creditors in the event of liquidation under s.53 of the Code.

Alternatively, when the Commercial Tax Department, Income Tax Department and Central Excise Duty department of the State of Chhattisgarh, were granted 100% of their dues with respect to the resolution plan, as opposed to the financial creditors who were sanctioned with only 9% of their dues, the NCLAT rightfully held that the 'Financial Creditor' could not be discriminated against in the manner suggested by the Adjudicating Authority i.e by directing full payment to the 'Operational Creditors' who did not otherwise contribute to the operation of the Company but were entitled under

**Notes**

65 *Pr. DG of Income Tax v Synergies Dooray Automotive Ltd. & Ors.*, Company Appeal (AT) (Insolvency) No. 205/2017, pp. 29, 30 (NCLAT, 20 March 2019).

66 *RMS Employees Welfare Trust v Anil Goyal*, Company Appeal (AT) (Insolvency) No. 699 of 2018, p. 7 (NCLAT, 30 May 2019).

67 *Swiss Ribbons Pvt. Ltd. v Union of India*, (2019) 4 SCC 17.



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the existing laws.[68] Therefore, prior to the amendment, the statutory authorities were entitled to their dues constituting 'operational debt', according to either the approved resolution plan or the amount realised under liquidation.

### b) Binding power of the approved resolution plan on statutory authorities

Previously, the NCLT delegated issues regarding statutory dues to the statutory authorities for determination.[69] In fact, in a particular instance, the NCLT Chandigarh Bench categorically held that s.31(1) of the Code would be binding on all stakeholders except in respect of statutory dues.[70] However, the issue of waiver was left to the discretion of the government. This provoked confusion regarding treatment of statutory dues under the liquidation waterfall.

Alternatively, statutory authorities have also been aggrieved by the liquidation waterfall under s.53 of the Code. While trying to disprove their standing as operational creditors, the statutory authorities have argued that they do not form a part of the 'operational debt', thereby claiming that their dues were payable exclusively from the provisions under the Code. In rebuttal, the Petitioner relied on the Insolvency Law Committee report to establish the intention of the legislature inasmuch as the Government dues must be read under the definition of 'operational debt'. On this basis, the Petitioner contended that the tax payable under any taxing statute would be subject to the Code and that the approved resolution plan would be binding on the statutory authorities. The relevant portion of the report has been provided for ease of reference.

'The Committee decided that since the term 'repayment' under s.5(21) of the Code may not be suitably construed to include 'payment' of taxes or levies or such other dues arising under any law for the time being in force, it must be replaced with the term 'payment' which has a wider and more relevant import'.[71]

## Amendment

Owing to the new amendment, the binding authority of resolution plans under s.31(1) now stretches to the central government, state government and local authorities to whom a debt arising out of any existing law is owed. In fact, it specifically includes authorities to whom statutory dues are owed.

Concurrently, s.240 of the Code has also been amended to replace 'repayment of debts of operational creditors' with 'payment of debts'[72] in order to facilitate the universal applicability of the Code. For the purposes of analysis, key implications arising from the amendment are discussed below.

### *Implications*

- The amendment ensures that the approved resolution plan shall be binding on all stakeholders, including government bodies and statutory authorities.
- If a resolution plan has waived or diminished any statutory dues, the Central, State or local authorities will have to comply with the decision. However, the capacity of the adjudicating authority to enforce or reverse such waiver or effectuate any reduction in statutory dues would have to be clarified by the Courts.

## Conclusion

The Insolvency and Bankruptcy (Amendment) Act 2019 comprehensively deals with the hornet's nest following the NCLAT order in the *Essar Steel* case. On the subject of resolution plans, it incorporates corporate restructuring schemes in the resolution proposals including mergers, amalgamations and acquisitions. The Code removes any ambiguities regarding the external time line prescribed for the insolvency resolution process while limiting it to an all-inclusive period of three hundred and thirty (330) days. With respect to the rights of stakeholders, it ensures 'fair' and 'equitable' payments for operational creditors as well as dissenting and unsecured financial creditors whilst restoring the credit hierarchy under the Code. Furthermore, it brings uniformity in the binding capacity of resolution plans against all stakeholders, including without limitation, statutory authorities. These changes will encourage small and medium scale industries to take risks and ultimately aid in recycling resources for a healthier economy.

**Notes**

68 *Ferrous Private Limited v Sunil Ispat & Power Limited.*, Company Appeal (AT) (Insolvency) Nos. 250-251 of 2019, pp. 7,8 (NCLAT, 30 May 2019).
69 *Shri Seo Pal v Quality Rice Exports Private Limited,* CA No. 348/2018 In CP (IB) No. 48/Chd/Pb/2018, pp. 24 (NCLT, 4 October 2018).
70 *Ambey Constructech Private Limited v Sumat Kumar Gupta*, RP,CA No. 509/2018 in CP (IB) No. 09/Chd/Pb/2018, pp. 27 (NCLT, 20 February 2019).
71 *Tata Steel BSL Limited v State of Odisha*, WP (C) No. 2914 of 2019, Orissa High Court.
72 Section 240 of the Code.


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